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**THE IMPACT OF POLITICAL CONNECTEDNESS ON  
CORPORATE GOVERNANCE DISCLOSURE: EMPIRICAL  
EVIDENCE FROM PAKISTAN**

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*A thesis submitted to The Open University, UK for the degree of  
Doctor of Philosophy*

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## **Abstract**

This research examines how political connectedness influences the corporate governance disclosure practices of listed companies. The research also explores the process of preparation of annual reports and seeks explanations on decision making, regarding the level and nature of corporate governance disclosure.

This research uses annual report data from companies listed on the Karachi Stock Exchange from 2009–2013. The research utilises qualitative content analysis for the study of the disclosure practices of politically connected and non-connected firms. An in-depth analysis of silence has been conducted focusing on the incidence of the lack of information on corporate governance. Furthermore, semi-structured interviews have been conducted in order to seek deeper insights into the research phenomena and the triangulation of findings.

The findings of the qualitative content analysis indicate that non-connected firms disclose a higher level of voluntary, as well as mandatory corporate governance information, in comparison with politically connected firms. However, the variation in the level of voluntary disclosure is found to be higher when compared with mandatory disclosure. The results of the analysis of silence indicate that politically connected firms stay silent on a diverse range of voluntary disclosure items and provide notably limited disclosure. The findings of interview data analysis are consistent with the findings of qualitative content analysis and the analysis of silence in annual reports.

To make sense of the findings the research has called upon the dual perspectives offered by agency theory and rational choice institutionalism. In assessing the implications of disclosure/non-disclosure practices it is found that the decision to disclose information is driven by the self-interest and

## Abstract

opportunism of politically connected members of the board who avoid voluntary disclosure of information. However, it is also found that rationality plays an important role and while the firms are operating in a tight regulatory environment, politically connected firms provide better mandatory disclosure.

## Chapter 1 – Introduction

### 1.0 Introduction

Corporate governance refers to the way in which organisations are directed and controlled (Cadbury, 1992). Wu (2005, p. 17) argues that corporate governance is concerned with the allocation of organisational resources such as power, privileges and economic benefits amongst stakeholders in corporate organisations. In any political system, this allocation is often influenced by the political power held by these stakeholders. Shliefer and Vishney (1997, p. 738) state that “corporate governance mechanisms are economic and legal institutions that can be altered through political process”. As corporate governance regulations aim at influencing the allocation of organisational resources, the implementation and enforcement of corporate governance mechanisms, such as corporate disclosure, might be resisted by various influential groups in organisations (Wu, 2005).

However, there is a scarcity of empirical literature on the impact of political influence on corporate governance disclosure. This research has attempted to fill this gap in existing literature through an in-depth empirical investigation into the context of a developing country, namely Pakistan. This research undertakes an analysis of the impact of political connectedness on the disclosure of corporate governance information in the annual reports of Pakistani listed companies. Figure 1.1 represents the structure and framing of this thesis.

**Figure 1.1: Chapter 1 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan's Institutional Context: Relevance with Other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
<b>Methodology Selection</b>	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical considerations</li> <li>– Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The influence of Political Connectedness on Corporate Governance Disclosures</li> <li>– Conclusion</li> </ul>
<b>Findings and Conclusion</b>	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>

This chapter will provide an overview of the structure and content of this thesis. Section 1.1 explains the rationale for this research. Section 1.2 explains the personal motivations for carrying out this research. The objectives of this research, along with the research questions, are elaborated in Section 1.3. Section 1.4 explains how this research has contributed towards the development of knowledge in the field of corporate governance disclosure.

### **1.1 Research Rationale**

This study of corporate governance disclosures has been undertaken for several reasons. First, numerous reports pertaining to corporate governance, such as Treadway (1987) in the USA and Cadbury (1992) in the UK, have placed special emphasis on the quality of reporting and the internal control mechanisms of corporate governance (Green and Graham, 2005; Lin et al., 2014). In Pakistan, international financial institutions such as the International Monetary Fund, the International Finance Corporation and the Asian Development Bank have played an important role in the adoption of International Financial Reporting Standards and the implementation of an Anglo-Saxon model of corporate governance in the country (Ashraf and Ghani, 2005; Mumtaz, 2005). It might therefore be inferred that regulators of business corporations around the world, as well as in Pakistan, place great emphasis on the corporate governance and disclosure practices of listed companies.

Second, academics emphasise the usefulness of the disclosure of information in corporate communication. The consequences of ineffective corporate governance and unreliable financial reporting include a lack of investor confidence (Rezaee, 2004; Kumar and Zattoni, 2014), poor accounting practices and weak internal control mechanisms (Uwuigbe et al., 2014).

Financial scandals such as Enron highlighted the need for greater accountability and transparency, and raised concerns about the practices of corporate boards and managerial misconduct. Bujaki and McConomy (2002) argue that firms disclosing poor quality of corporate governance information run into corporate governance failures. Thus, prior literature on corporate governance disclosure recognises that good corporate governance and disclosure are important mechanisms for ensuring transparency in corporate affairs, preventing frauds and safeguarding against corporate failures. This significant concern of academic researchers in the area of corporate governance disclosure has also constituted as an important reason for carrying out this research.

The third reason for carrying out research on corporate governance disclosure practices stems from the argument that the board of directors is the holder of managerial powers in Anglo-Saxon countries (Heracleous and Lan, 2012), holding a central position in the corporate governance system (Daily et al., 2003). However, researchers have recognised that accessing board members is a difficult task. Hence, existing research lacks understanding of what actually happens in board meetings (Leblanc and Schwartz, 2007; Payne et al., 2009). Green and Graham (2005) assert that corporate disclosures provide a source of information in regard to decisions making and strategy formulation during board meetings. Therefore, an in-depth investigation into disclosure practices enables a closer analysis of the role of the board of directors in influencing corporate governance disclosures.

Another reason for carrying out this research stems from the argument that there is a lack of empirical research on the influence of political connectedness<sup>1</sup> on corporate governance disclosure. The influence of politics on corporate reporting and disclosure has been recognised by prior literature. Tinker and Neimark (1987) recognise the role of political influences on corporate reporting and argue that accounting information and disclosure are not merely ways of transmitting objective accounting facts, but instead comprise a socially constructed reality. They further assert that corporate disclosure is used as a tool for the dissemination of wealth and power among leaders. Shleifer and Vishny argue that political processes have the potential to alter corporate governance mechanisms (1997, p. 738).

Roe (2003) has also argued that a firm's political environment may profoundly impact the development of national as well as firm-level corporate governance mechanisms. For instance, Roe (2003) argues that the political context may determine which type of ownership structure and corporate governance arrangements persist and develop within the context of an economy. Different laws and regulation found in different countries attribute to differences in their political environment (La Porta et al., 2000). Since regulatory bodies introduce and enforce corporate governance codes and guidelines, the development and enforcement of corporate governance mechanisms (such as corporate disclosure) is influenced by political power held by various stakeholders. However, empirical research on the impact of political influence on corporate disclosures is limited, largely quantitative and provides contradicting evidence (Bushman et al., 2004; Chaney et al., 2011; Sari and Anugerah, 2011). Owing

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<sup>1</sup> Consistent with the definition provided by Khwaja and Mian (2005), this research has considered a firm to be politically connected if it has a politician serving as a director on its board. Please refer to section 3.1 for a detailed account of relevant literature on the definition of political connectedness.

to these reasons, an in-depth investigation has here been carried out to explore the process of the preparation of annual reports in listed companies, seeking explanations of how political influence affects corporate governance disclosures.

The legal and political context of Pakistan has rendered it an appropriate case for the study of political influence on corporate governance disclosures. Pakistan is a developing country with weak law enforcement and high levels of political corruption (Easterly, 2001; Anwar, 2006). The capital market in Pakistan is highly concentrated and firms use political connections for extracting rents, such as preferential access to credit and subsidised interest rates (Khwaja and Mian, 2005; Saeed, 2013). Bushman et al. (2004) assert that in countries with weak law enforcement, relationship-based arrangements and private mechanisms for enforcement of contracts emerge. Firms avoid the dispersal of equity to outsiders and the resulting equity markets are thus highly concentrated with greater emphasis placed on personal relationships. Bushman et al. (2004) further argue that, in order to meet their political interests, the politically powerful elite favour their acquaintances in return for bribes, political support and nepotism.

Considering the institutional context of Pakistan (explained in detail in Chapter 2), it was considered an appropriate case for the study of political influence on corporate governance disclosures. Like many other developing economies, Pakistan's capital market is less liquid and manifests the characteristics of poor investor protection, family control of listed companies and strong corporate-political connections, while the legal system in the country is also weak (Rabelo and Vasconcelos, 2002; Tsamenyi et al., 2007).



Furthermore, Pakistan like many other developing countries has implemented an Anglo Saxon model of corporate governance, with its focus on separation of ownership and control. This model of corporate governance places a special focus on reducing information asymmetry and protecting investor interests through the introduction of corporate governance and reporting regulations. The findings of this research will therefore provide insights that could be applied in the investigation of other countries sharing a similar capital market structure and institutional context. This research hence advances the agenda for carrying out in-depth research in the context of these countries, thus examining the compatibility of externally developed corporate governance regulations in the institutional context of these countries.

The Anglo-Saxon model of corporate governance is based on an agency theory perspective. An agency theory perspective views corporate governance as a mechanism devised for resolving agency problems arising from the separation of ownership and control in corporate organisations (Berle and Means, 1932; Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983). Agency theory assumes that the principals (owners) hire the agent (manager) to derive some benefit from the agent's expertise, skills and knowledge to maximise returns on his/her investment. The agent thus serves the principal and is entitled to remuneration for these services. However, agency theory recognises that human beings are opportunistic in nature and managers (agents) will not always work in the best interest of the principal (owner), maximising their personal gains over the principal's interests.

Agency theory thus points out the information asymmetry problem between the principal and agent. The agent, being an insider, possesses superior knowledge

and might misstate the prices of various financial instruments and manipulate information on various business transactions (Arnold and Lange, 2004). This will then give rise to the problems of the lack of transparency and disclosure in corporate communication. Corporate governance and disclosure regulations such as Sarbanes Oxley Act in the USA were introduced with an aim of reducing information asymmetry through accurate and reliable corporate disclosure (Healy and Palepu, 2001; Abdioglu et al., 2015).

Fan and Wong (2002) argue that in developing countries, capital markets display concentrated ownership structures and agency conflict might then be observed between controlling owners and minority shareholders. Fan and Wong (2002) assert that closely held firms are more likely to be politically connected as politicians use concentrated ownership structures to control the flow of information regarding their secret transactions with the government. The controlling owners are thus politically connected and they control the disclosure of information to public. Shleifer and Vishny (1994) argue that politicians' involvement in company affairs (such as being members of the board) results in their bargaining with managers, whereby they offer bribes to the managers in pursuit of their political interests. Thus despite being the agents of the shareholders, politically connected members of the board work to meet their personal political interests. Thus, the presence of politically connected members on boards ultimately leads to lower level of disclosures and transparency.

This research also draws upon the theoretical underpinnings of rational choice institutionalism. Rational choice institutionalism recognises that social actors have utility maximising preferences and they behave in a strategic manner to

achieve those preferences. The attainment of self-serving preferences might then lead towards collectively unfavourable outcomes (Hall and Taylor, 1996). Hall and Taylor (1996) further argue that, through an analysis of institutional environment, social actors make calculations about the behaviour of other social actors and devise their strategic action plan accordingly.

It can therefore be argued from the perspective of rational choice institutionalism that politically connected members of the board try to maximise their personal political interests. They also take into consideration the high level of political corruption and weak regulatory institutions prevailing in the country. Thus, they might be involved in such behaviours as shirking and the expropriation of the rights of minority shareholders. Thus disclosure of information in the annual reports of politically connected firms is likely to be restricted for the purpose of hiding such activities as shirking and expropriation.

Consistent with the views of Hendry (2005, p. 55) this research has adopted ‘the position of theoretical pluralism’ in the investigation of complex phenomena. The limited ability of agency theory to explain real life situations has been dealt with by the use of the additional perspective of institutionalism that helped to capture the complexity inherent in real life. Peters (2005) has emphasised the use of several approaches for understanding complex phenomena. In turn, Dacin (1997) argues that it is not only institutional forces that affect organisations over time, but organisational ecological<sup>2</sup> and economic factors also play an equally important role and should be well thought out in organisational studies.

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<sup>2</sup> Baum, J. A. (1996) explains that organisational ecology aims to study the influence of the political, social and economic environment on the emergence of diverse organisations.

Owing to these arguments, this research combines the agency and institutional approaches for the development of careful and logical propositions. The differences in the theoretical lenses have been used to provide complementary explanations, rather than highlighting contradictions. The empirical research was carried out in the institutional settings of Pakistan, whereby the initially established propositions were treated as socially constructed realities that were subject to variations specific to a unique context.

Existing research on corporate governance disclosure and political influence has been limited and mainly quantitative; this relationship has therefore not earlier been examined through an in-depth study. In addition, to the best of researcher's knowledge, no such in-depth investigation has so far been conducted in Pakistan, as an under-researched developing economy. This research fills these gaps through an examination of how and the extent to which these influences operate in real life situations. This study focuses on investigating how listed companies disclose corporate governance information in annual reports and how political connectedness influences corporate governance disclosures

### **1.2 Personal Motivations for the Study**

My personal motivation for this study has developed from my observation of the close ties between business and politics in the institutional environment of Pakistan. My curiosity in this area increased as I could observe that international organisations such as the Asian Development Bank and World Bank have played a major role in improving enforcement and awareness regarding corporate governance in Pakistan (Javid and Iqbal, 2010). On the one hand I could thus observe the Code of Corporate Governance (2002) being

introduced and the efforts made for its effective implementation with an expectation that better corporate governance would result in increased corporate transparency and better disclosure. On the other hand, various news and media reports indicated the existence of a close nexus of business and politics with a high level of political corruption prevailing in the institutional set-up of the country. I felt increasingly interested in studying whether the introduction and awareness regarding better corporate governance and good disclosure had a similar influence on the practices of the companies having political connectedness, as they had on non-connected companies.

My initial motivation to carry out this research was supported and further increased by the academic research that recognises the negative impact of political connectedness on corporate transparency and disclosure (Bushman et al., 2004; Chaney et al., 2011). I was puzzled how politically connected companies could avoid the disclosure of information in an environment where a lot of attention and emphasis had been placed by international organisations and the Securities and Exchange Commission of Pakistan on improving corporate transparency. It was also interesting to note that there was a lack of relevant research carried out in the corporate context of Pakistan.

The predominant use of agency theory in the existing corporate governance and disclosure literature served as another motivation for this research. As most of the existing research in the field of corporate governance is quantitative, various researchers have criticised the predominant use of agency theory in the field (Lubatkin et al., 2007; Van Ees et al., 2009). Lubatkin et al. (2007, p. 43) argue that the principal-agent model is flawed as it is based on “a number of simplifying assumptions intended to reduce the complexity of the governance

phenomenon.” Lubatkin et al. (2007, p. 43) further argue that “while this reductionist approach may enhance the model’s precision and, in turn, its scholarly appeal, it endangers an under socialised view of principals and agents, thereby reducing the model’s relevance.” It implies that the agency theory assumption of human self-interest is too simplistic and has been used by economists to develop economically efficient models. However, these rigid assumptions about opportunistic human nature ignore the role played by the context and the institutional environment in shaping human behaviour and board decision making.

In response to this criticism, Wiseman et al. (2012) argue that an agency theory perspective provides a useful lens for the analysis of corporate governance issues. Wiseman et al. (2012) further argue that the objection that agency theory ignores the institutional and social context of principals and agents can be removed by introducing institutional factors as variables in the existing agency framework. Thus, institutional factors are introduced as intervening variables that influence agent’s behaviour in the agency framework proposed by Wiseman et al. (2012).

In turn, Heracleous and Lan (2012) proposed a legal perspective on agency theory. Heracleous and Lan’s (2012) legal perspective holds that the traditional assumption of shareholders being principals is not accurate. The corporation in itself, by being an independent legal entity, is the actual principal. Therefore, as per law, directors should protect the interest of the whole corporation contrary to the traditional shareholder perspective. Heracleous and Lan (2012) further argue that directors are not the agents, but autonomous fiduciaries of the corporation and that they will always work in best interests of the organisation.

The directors also act as mediators between various parties in corporate organisations and thus reduce uncertainty and mistrust. Heracleous and Lan (2012) thus assert that this model is more sensitive to institutional factors and open to an inductive investigation.

These theoretical debates caught my attention and I felt greatly motivated to study how well the agency theory perspective could explain the disclosure practices of listed companies in the real life context of Pakistan. In order to address the calls for using multiple theoretical perspectives (Eisenhardt, 1989; Hendry, 2005; Peters, 2005) for the study of corporate governance research, I used the agency theory perspective along with rational choice institutionalism for the purpose of developing initial research propositions.

The use of these theoretical perspectives not only helped in the determination of the scope of my research but also enabled me to focus on the phenomenon under research. It also helped me to be aware about the importance of institutional factors and the richness of the context in which the research was to be carried out. I was determined to observe the phenomena and accept all possible explanations. Thus this research is differentiated from prior research, in that it combines both the institutional and agency perspectives. The research has also gone one step further in investigating empirically whether the traditional model of agency is sufficient to explain the investigated phenomena.

To sum up, my motivation for this research started from a practical observation of the context in which this research was later carried out. However, the existing academic literature and the gaps identified therein have provided a strong motivation for an empirical investigation.

### **1.3 Research Objectives and Questions**

The review of the existing literature (Chapter 3) has exposed gaps in the relevant research on political connectedness and corporate governance disclosure. The political affiliations of corporate organisations are not recently studied phenomena. Existing research recognises that politicians develop connections in the business sector so as to extract rents<sup>3</sup>. The importance of political connections is distinct in developing countries as political connections help corporate organisations to access utilities, obtain subsidies, win contracts, access preferential treatment, access capital and gain other undue benefits (Domadenik et al., 2014). This research was conducted in the context of Pakistan being that there is a strong connection between business and politics in the institutional environment of Pakistan. Thus the review of literature, along with an analysis of the context in which the research was to be carried out, has informed the development of the following objectives for research:

1. to analyse the process of preparation of annual reports so as to understand the role of the board in decisions regarding corporate governance disclosure;
2. to examine the preferences of listed companies regarding mandatory and voluntary corporate governance disclosure;
3. to explore the perceptions of senior management in listed companies, statutory audit firms and regulatory bodies regarding political influence on disclosure practices of listed companies in Pakistan;
4. to explore the differences between voluntary corporate governance disclosure practices of politically connected companies and non-connected companies;

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<sup>3</sup> A detailed review of this literature is provided in Chapter 3



5. to explore the differences between mandatory corporate governance disclosure practices of politically connected companies and non-connected companies;
6. to explore the underlying motivations of politically connected members of the board in influencing listed companies in relation to their voluntary corporate governance disclosure practices; and
7. to explore the underlying motivations of politically connected members of the board in influencing listed companies in regard to their mandatory corporate governance disclosure practices.

In order to achieve these objectives, answer to the following key question was sought.

‘How does political connectedness influence the disclosure of corporate governance information in annual reports of listed companies in Pakistan?’

In order to obtain the answer to this central question, following sub questions were developed

1. How do listed companies in Pakistan disclose corporate governance related information in annual reports?
2. How does political connectedness influence the disclosure of mandatory corporate governance information in the annual reports of listed companies in Pakistan?
3. How does political connectedness influence the disclosure of voluntary corporate governance information in the annual reports of listed companies in Pakistan?

There are seven chapters to this thesis. The following sections provide an overview of Chapters Two to Seven.

#### **1.4 Overview of the Thesis and Contribution to Knowledge**

Chapter Two of this thesis contains information about the institutional background of this research. This background information is particularly important as this is a qualitative piece of research and recognises that providing an understanding of the institutional environment in which corporate governance disclosure is practiced is the key for seeking explanations to research phenomena. This chapter explains the existence of the close nexus between politics and business in Pakistan. It sets the contextual foundation for examining how agency relationships are affected by the institutional environment of a country.

This chapter is particularly significant as it explains that the institutional environment of Pakistan is similar to the institutional environment prevailing in many developing countries across the world. It highlights that Pakistan shares the characteristics with many other developing countries, such as concentrated and less liquid capital market, weak legal system, poor investor protection and family control and strong connection of politicians and business enterprises (Rabelo and Vasconcelos, 2002; Tsamenyi et al., 2007). It is argued that although this research is a qualitative study, the findings of this research might be generalisable in other countries sharing a similar capital market structure and institutional context.

The literature review is provided in Chapter Three. This chapter starts with an explanation of the various ways by which political connectedness is defined in literature. An explanation is provided about the definition of political connectedness as it has been used in this research. It is followed by an explanation of the distinctive nature and importance of political connectedness

in developing countries as the research was carried out in a developing country; that is, Pakistan. The review of literature provided in this chapter shows that, so far, there has not been any prior research investigating the impact of political connectedness on reporting and disclosure practices of listed companies in Pakistan.

This chapter also provides relevant literature on the impact of political connectedness on corporate reporting and disclosure. Here, it is argued that although several studies have investigated the impact of political connectedness on the quality of financial reporting, there are currently no studies investigating the impact of political connectedness on the corporate governance disclosure practices of listed companies. In addition, the existing research has predominantly utilised the agency theory perspective for conducting quantitative investigation. Therefore, for the purpose of gaining deep insights, this research has used the agency theory perspective in conjunction with rational choice institutionalism. Various recent debates and suggestions regarding a socialised version of agency theory were taken into account. Initial research propositions were developed for the purpose of directing the scope of the future research. It is proposed to analyse the so-called *positivist* and *rigid* assumption of self-interest in the institutional context in which social actors make disclosure decisions.

Research methodology and methods are discussed in Chapter Four. This chapter provides an explanation of various choices made during the process of research. Research data includes 200 audited annual reports of 40 listed companies from various industrial sectors from 2009 to 2013 along with 20 semi-structured interviews conducted with representatives from listed companies, audit firms and regulatory authorities.

Three methods are used for data analysis. Firstly, the annual report data of politically connected and non-connected companies was analysed to gauge differences in corporate governance disclosure. Secondly, an in-depth analysis of the narrative sections of annual reports was carried out to observe the incidence of 'silence' (as defined in detail in section 4.3.2) on corporate governance affairs. Thirdly, a template analysis was carried out to develop an understanding of the interview data obtained from the representatives from listed companies, regulatory bodies and statutory audit firms. This research project is different from prior research because it is an in-depth study using qualitative methods for analysis. The use of qualitative methodology facilitated the acquisition of a deep and context based understanding of the phenomena under study. In addition, the use of multiple methods of analysis has helped in triangulation.

The findings and discussion of content analysis and analysis of silence are provided in Chapters Five and Six. Chapter five explores the level of corporate governance information in annual reports. A comparison of voluntary corporate governance disclosure with mandatory corporate governance disclosure is then provided. The results of the analysis revealed that companies in all sectors have provided high mandatory disclosure while the level of voluntary disclosure is poor. The chapter also explains the variations in the level of disclosure among politically connected and non-connected firms. The level of disclosure in the annual reports of politically connected firms has been found lower in comparison to non-connected firms. This chapter also highlights that politically connected firms become silent on various voluntary corporate governance matters. It therefore makes a contribution to knowledge, whereby evidence has

been found and explanations are provided regarding the nature and existence of agency conflict in the capital market of Pakistan.

Chapter Six provides findings from the template analysis of the semi-structured interviews. The analysis of interview data provided information about the process of preparation of annual reports along with an explanation of the role of board members in influencing information regarding corporate governance. The analysis of the interview data supports findings from the content analysis and the analysis of silence because the participants generally asserted that politically connected companies do not disclose corporate governance information voluntarily. This chapter also makes a valuable contribution to knowledge by linking the findings of empirical research to the theoretical underpinnings of the research.

Chapter Seven concludes this thesis. This chapter summarises the findings of this research. Contributions to the knowledge are outlined along with an overview of the quality of this research. This chapter also explains the various limitations of this research and outlines an agenda for future research.

## **Chapter 2 – The Institutional Background**

### **2.0 Introduction**

This chapter will provide background information on the existing governance and regulatory environment of Pakistan. This background information will highlight the need for and the significance of a context-based study of an under-researched developing economy.

Section 2.1 of this chapter explains why the study of political influence is interesting in the context of Pakistan. Section 2.2 provides an account of the socio-cultural, political, judicial and administrative environment in Pakistan. This sections serves to explain how these institutional factors have contributed towards the development of business organisations and the equity market in the country. It also maps out the close ties between business and politics in the highly corrupt political set-up prevailing in the country (Transparency International, 2014).

Section 2.3 provides information about the capital market structure prevailing in the country. Here, it is explained that the capital market of the country is highly concentrated and family businesses are a dominant feature of the market. Section 2.4 provides information about the development and implementation of the code of corporate governance in Pakistan. This section briefly outlines the existing regulatory set-up of the country regarding corporate reporting and disclosure. Section 2.5 explains that the findings of this study might be quite useful as they are generalisable to other developing countries sharing similar institutional characteristics as Pakistan. Section 2.6 concludes the chapter.

The information about the background for the research is especially important as this research will utilise qualitative techniques for analysis of data (explained in

detail in Chapter 4). Qualitative research assumes that knowledge and awareness of research context help in identifying and explaining the behaviours of individuals in their institutional settings (Hennink et al., 2010). Thus qualitative research methodology has enabled the researcher to shed light on the entire process of the preparation of annual reports in Pakistani listed companies and included the assessment of the actual corporate governance disclosure provided in annual reports of politically connected and non-connected companies. Figure 2.1 illustrates how this chapter intends to provide the backdrop for this research.

**Figure 2.1: Chapter 2 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan's Institutional Context: Relevance to other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
<b>Methodology Selection</b>	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical considerations</li> <li>– Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The Influence of Political Connectedness on Corporate Governance Disclosures</li> <li>– Conclusion</li> </ul>
<b>Findings Conclusion</b>	<ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>



### 2.1 Background to the Study

Pakistan manifests poor levels of performance in various dimensions such as governance effectiveness, political stability, rule of law, democracy and accountability (Easterly, 2001; Anwar, 2006). The constitution of Pakistan has allocated distinct and separate roles to the executive, legislature and judiciary. As per the constitution, the judiciary has been made responsible for ensuring that the executive and legislature adhere to the provisions of the constitution.

However, since the establishment of Pakistan, military forces in the country have actively intervened in politics and toppled several democratic governments. The judiciary has also supported these military interventions through the provision of legitimization and approval to each military dictator (Hassan, 2007). Easterly (2001) elaborates that, owing to constant political instability coupled with military interventions and take-overs of national government, Pakistan could not initially develop appropriate structures for public sector governance. The governance institutions inherited from the undivided India were not adapted to the requirements of the changed expectation level and demands of the general public.

This failure of the governments to cater to public expectations and demands has resulted in major political setbacks for the country. One of the most noticeable political setbacks led to the break-up of the country in the form of the separation of East Pakistan in 1971. The following discussion will provide an account of the institutional context of Pakistan, whereby a comprehensive analysis of socio-cultural, political, legal and judicial environment will be provided.

## **2.2 The Institutional Framework in Pakistan**

An institutional framework plays a substantial role in the development of any economy. A strong institutional framework supports the system of governance in an economy and results in the development of strong capital markets, increasing shareholder value and reducing business risk (Javid and Iqbal, 2010). Hodgson (2006, p. 2) defines institutions as “systems of established and prevalent social rules that structure social interactions.” North (1990) argues that the institutions in a society outline informal rules regarding acceptable and unacceptable human behaviour. North (1990) further argues that institutions can be formal as well as informal. However, he neither defines clearly nor differentiates between formal and informal institutions.

Williamson (1998) has focused on this differentiation, explaining that informal institutions consist of social and cultural norms, traditions, customs and religious values. Formal institutions, as explained by Williamson (1998), constitute polity, judiciary and bureaucracy in an economy. The following sections will provide an overview of the informal as well as formal institutional framework prevailing in Pakistan.

### **2.2.1 Informal Institutions**

Informal institutions include historical norms and belief systems prevailing in a society. South Asian history has a deep impact on the socio-cultural environment in Pakistan. The impact of British rule on the structuring and operations of institutions is also evident. On the one hand, Pakistan is an Islamic country, but on the other hand the societal traditions are deeply influenced by the mixed social system of Hinduism, Sikhism and Islam that prevailed in the undivided India.

### *a) Socio-cultural Environment*

Afghan and Wiqar (2007) argue that Pakistani society is a collectivist<sup>4</sup> society. Here it is argued that people in Pakistan prefer to be recognised on the grounds of relationship-based clusters such as family, caste and tribes. People derive their norms and values from this clan and tribe system. Marriages between cousins are used as a tool to retain family togetherness, and to ensure that land and assets stay within the same family (Afghan and Wiqar, 2007).

Kinship networks and family ties are central to all social networking. This strong kinship and familial system exerts a deep influence on the political and corporate system in the country. These strong ties promote a culture of nepotism within the national political environment. People extend undue favours to their relatives, which results in high levels of political corruption in the country. The corporate sector also operates under a strong family system, whereby most of the businesses are family owned and controlled (Islam, 2004).

Afghan and Wiqar (2007) argue that Pakistani society is highly ‘power distant’<sup>5</sup>. Being that the family system is highly centralised, the head of the family is considered to be the centre of the power. Society believes in a highly unequal distribution of authority. A strong family system inhibits younger members from challenging the authority of elders in the family. Experience and seniority are also linked to power and authority. Siblings are encouraged to have close ties among themselves in order to ensure family solidarity.

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<sup>4</sup>Hofstede (1984) defined collectivism as the extent to which people prefer to stay in closely knit social framework, whereby the members of family, clan or tribe are expected to provide favours in return for an expectation for unconditional loyalty.

<sup>5</sup>Hofstede (1984) defined power distance as the degree to which a society accepts power hierarchy and inequality.

Masculinity is another important dimension for cultural analysis of a society. Afghan and Wiqar (2007) explain that masculinity refers to the emphasis placed on heroism, assertiveness and achievement. Pakistani society is highly masculine as gender roles are strongly prescribed. Women are not expected to assume leadership roles<sup>6</sup>, and men are expected to take charge of the family. Men are the bread-winners and are inheritors of family businesses. These socio-cultural factors have a deep influence on the development of the business environment of Pakistan. Consequently, family businesses with strong control by family members are a norm in Pakistan's cultural set-up.

The following section will describe the development, structure and role of the judiciary, bureaucracy and polity in Pakistan. This description of the institutional environment will be accompanied by an explanation of how this environment has influenced the development of business organisations and capital market in Pakistan.

### **2.2.2 Formal Institutions**

According to Williamson (1998), formal institutions consist of the polity, judiciary and bureaucracy in an economy. This section will provide an account of the formal institutional environment prevailing in Pakistan.

#### ***a. Judicial and Legal Environment***

The judicial system in Pakistan has evolved under the influence of various social norms, religious doctrines and political establishments, both pre- and post-colonisation of India before its division. Subsequent to the partition of the

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<sup>6</sup> Haeri (2002) provides the example of Benazir Bhutto, who was elected as a Prime Minister in Pakistan for two non-consecutive terms. Haeri (2002) explained that Benazir Bhutto dealt with the problem of social resistance by covering her head, accepting an arranged marriage, avoiding shaking hands with men at international meetings and thus met the social code of purity and honour for Pakistani women.

Indian subcontinent in 1947, the Government of Pakistan decided to retain the Government of India Act 1935. Therefore, the existing judicial system has its roots in the system that prevailed before partition of India (Hussain, 2011).

The existing judicial system is comprised of the Supreme Court, provincial high courts and lower courts. The Supreme Court of Pakistan is the final Court of Appeal in matters that remain unsettled at provincial level. The Supreme Court is also the custodian of the constitution in the country. Provincial high courts deal with the cases that fall within each provincial court's territorial jurisdiction. Lower courts include district courts. District courts are further subdivided into civil and criminal courts and deal with the cases falling under their jurisdiction respectively. The President of Pakistan appoints the Chief Justice of Pakistan. The President also appoints other judges of provincial high courts in consultation with the Chief Justice and the Governor of the province in which the appointment is to be made (Yasmeen and Ali, 2011).

The judicial system of Pakistan has been criticised for long delays in the provision of justice and variance in the level of justice provided to different sections of civil society (Chemin, 2009; Siddique, 2011). Siddique (2011) asserts that the judicial system in Pakistan serves justice to the people either on the basis of their class or their ability to access various resources such as relationships and wealth. In addition, access to justice is extremely expensive and subject to long delays. The existing literature asserts that the governments of Pakistan have failed to develop a strong judicial system since its inception in 1947, while the existing judicial machinery is both inefficient and ineffective (Chemin, 2009).

The legal system, and especially its origin, are acknowledged to have a deep impact on accounting practices in an economy (Hope, 2003). Pakistan's legal system is characterised by weak law enforcement mechanisms (Ashraf and Ghani, 2005). Pakistan is a common law country. La Porta et al. (1997) argue that common law countries provide better protection to investors and are characterised by strong capital markets when compared with civil law countries. However, despite the fact that Pakistan is a common law country, it is characterised by weak law enforcement, has a small and concentrated capital market, and corporations in Pakistan heavily rely on bank financing instead of equity financing (Ashraf and Ghani, 2005). The explanation of this paradox might be found in La Porta et al.'s (1997) argument that, in countries with a poor quality of law enforcement, businesses have fewer opportunities to access external (equity) finance. Therefore, these companies rely on bank financing, which ultimately results in the prevalence of small equity markets (Ashraf and Ghani, 2005). In addition, owing to weak law enforcement and investor protection, small investors are powerless to obtain a return on their investment. Consequently, in the absence of strong legal protection, investors tend to make large investments so that they have a greater control on the firm's affairs, ultimately leading to the prevalence of concentrated ownership structures (La Porta et al., 1997).

Shareholder rights are not protected in Pakistan's legal system (Hamid and Kozhich, 2007). In addition, the legal system also lacks the expertise required for handling corporate complaints. Several steps have been taken to improve the situation, and judges having an expertise in corporate law are appointed in provincial courts for the resolution of corporate disputes. However, Hamid and

Kozhich (2007) assert that the overall situation of the system of provision of justice in the country is fragile.

### ***b. Bureaucracy in Pakistan***

The bureaucratic system in Pakistan was adopted from that prevailing in India before division. This former bureaucratic system was highly centralised and was administered by the Indian Civil Service (Wilder, 2009). Thus, the bureaucratic system adopted by Pakistan was also administered by its Civil Service.

Civil Service reforms were introduced in Pakistan in 1973 when the *Civil Servants' Act* (1973) was introduced. Under these reforms, all civil service cadres were categorised as occupational groups. The hierarchical structure in these occupational groups was linked to Basic Pay Scales (BPS). As ordered by the Constitution of Pakistan (1973), appointments in civil service of Pakistan were to be made by parliament, which is the supreme legislative body in Pakistan. The appointments for provincial civil servants were then to be made by respective provincial assemblies (Imtiaz, 2013).

Academics and international organisations have criticised the bureaucracy in Pakistan on account of its inefficient practices and high levels of corruption (Shafqat, 1999). The bureaucracy has been criticised for not being able to implement policies effectively, or to facilitate development. The existing literature outlines the reasons for this incapability. It has been argued that the bureaucracy works subject to the deep influence of political forces in Pakistan, whereby the appointments in government and administrative machinery are made on the basis of nepotism and political networking (Kalia, 2013). The high level of political influence has badly affected the capabilities and skill set of

government machinery in Pakistan. The link between performance and rewards does not exist because appointments, promotions and placements are made under political influence.

Kalia (2013) argues further that the politicians in the country are highly corrupt and are not interested in effective policy making. The regulations and policies are introduced on a preference basis instead of merit. In addition, the power and influence of politically corrupt elite makes it difficult for bureaucrats to implement policies effectively.

### *c. Political Environment*

Subsequent to its establishment in 1947, Pakistan adopted the *Government of India Act* (1935) after introducing slight amendments to it. The amended constitution served as an interim constitution for the country. The constitution currently applicable in Pakistan was developed in 1973. The 1973 constitution provides for a federal parliamentary system. The President is the head of the state. The Prime Minister is elected through a popular public majority and is the head of the government.

The Federal Legislature (Parliament) consists of an upper house (Senate) and lower house (National Assembly). The Senate serves as a permanent body for legislation and its term lasts for 6 years. The Senate is composed of an equal number of representatives from all provinces, Federally Administered Tribal Areas, and Islamabad Capital Territory. Seats in the National Assembly are allocated to representatives from all the provinces, Federally Administered Tribal Areas, and Islamabad Capital Territory on the basis of population.

The members of National Assembly are elected through general elections in the country and their term lasts for five years. In addition to the system of



federal legislature, the provinces in Pakistan are administered by a Governor and a publically elected Chief Minister. Each province has its own provincial assembly while the members of the provincial assembly are also elected in general elections. The term of provincial assemblies also lasts for five years.

Pakistan's political system is dominated by patronage. As discussed in Section 2.2.1, family relationships, networking and ties are very important in Pakistan's cultural set-up. The political environment of Pakistan also operates under the influence of these relationships and political power also moves from one generation to another within clans and tribes. Since its establishment in 1947, Pakistani politics has been characterised by the existence of powerful families, for example the Bhutto family, Shareef family, Choudhary family etc. The members of these political families have held the offices of Prime Minister, Chief Minister and other important positions in the national and provincial governments. These political elites hold enormous resources and these resources are transferred from one generation to the next in these political dynasties (Niaz, 2010; Mushtaq et al., 2013).

Another important characteristic of the political environment in Pakistan is the high level of political corruption. The following section will explain this feature in detail, along with an explanation of how these high levels of political corruption ultimately affect business and economy in Pakistan.

### ***Political Corruption***

Political corruption is considered to be one of the most pervasive problems in Pakistan's economy. In 2014, Pakistan was ranked as the 126<sup>th</sup> most corrupt country in the world, according to the Transparency International Corruption

Perception Index<sup>7</sup> (Transparency International, 2014). The Transparency International Corruption Perception Index provides the ranking based on the perception about the extent of corruption prevailing in the public sector of a particular country. Saeed (2013) explains that three democratically elected prime ministers, along with the respective national and provincial assemblies, were toppled before they could finish their term, on account of charges of corruption. It is also argued that corruption in Pakistan is not only limited to the political arena, for the society of Pakistan suffers all possible types of private, public, judicial, political and religious corruption (Javaid, 2010). In public sector organisations, most of the appointments at higher level are made on the basis of personal ties and nepotism (Khwaja and Mian, 2005).

### ***Ties between Politics and Business***

Another important characteristic of the political environment in Pakistan is the close linkage between business and politicians. The political families in Pakistan do not limit themselves to political activism: they also actively participate in business. All the leading participants in Pakistan's political arena also have strong business stakes. The close ties between business and politics result in a limited separation between business interests and the political interests of the parties involved (Saeed, 2013). Since politicians are involved in policy making, they might exert an influence on the formation of policies favourable to the corporate sector. In addition, since bureaucracy in Pakistan is not free from political influence, politicians might also exert an influence on the implementation and enforcement of these policies.

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<sup>7</sup>Andersson and Heywood (2009, p. 774) argue that although the Transparency International Perception index can be criticised on account of problems associated with the definition and measurement of corruption, the Index has nevertheless played an important role in academic research on corruption and is the "best available corruption indicator worldwide."

Amongst the number of researchers who have studied the impact of political connectedness on corporate sector, Correia (2009) argues that firms with political connections exhibit poor compliance with reporting regulations, being that such firms are less likely to be penalised for misreporting when compared with unconnected firms. As Pakistan's institutional environment displays weak law enforcement and high levels of political corruption, this research will investigate how political connectedness influences the level of corporate governance disclosures in politically connected firms.

### **2.3 Capital Market**

A well developed and robust capital market plays an important role in mobilisation of resources in the financial system. A well-established capital market might bring considerable improvement to the corporate governance standards of firms through the imposition and enforcement of rules and regulations (John and Senbet, 1998). An efficient capital market also acts as the provider of information between various stakeholders in listed companies, such as shareholders, regulators and investors.

The history of the capital market in Pakistan began soon after its foundation in 1947. The first stock exchange of Pakistan was established in September 1947 in Karachi. In 1970, the second stock exchange of Pakistan was established in Lahore, followed by the establishment of the Islamabad Stock Exchange in October 1989. Hussain and Qasim (1997) have discussed the historical developments of equity markets in Pakistan, stating that the number of listed companies in 1960 was 81. The stock markets flourished remarkably well during the early 1960s and by the beginning of 1970s the number of listed companies had reached 219.

However, later on, owing to socio-political instability, growth slowed down. In the early 1970s, the government nationalised all the large companies operating in the manufacturing, banking and insurance sectors of the economy. This was a major set-back for the development of equity market in Pakistan. As a result of nationalisation, seventy per cent of the country's economy went under direct government control while the remaining 30 per cent consisted of government-dominated, fully nationalised financial institutions.

In the 1980s, the government revisited its nationalisation policy and introduced a disinvestment programme of government-held shares. Private businesses were again encouraged to make investments in the financial system through investment banks. This encouragement resulted in the development of the capital market in the country and the number of listed companies rose to 314 in the 1990.

In the 1990s, the government initiated move towards privatisation, coupled with increased encouragement for private sector investors. The resulting progress of the equity market can be summarised by the fact that while the number of listed companies on the Karachi Stock Market<sup>8</sup> in 1949 was five, it reached to 762 in 2000. Information in Table 2.1 shows the development of KSE over the years.

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<sup>8</sup> Data from the Karachi Stock Exchange has been taken as being representative of the overall situation of the equity market in Pakistan, on the basis of the assumption that Karachi Stock Market is the largest and the most volatile stock exchange in Pakistan. See Hussain and Qasim (1997).

<b>Table: 2.1 Growth of the Karachi Stock Exchange</b>		
<b>Year</b>	<b>Number of Listed Companies</b>	<b>Listed Capital (PKR in Million)</b>
1949	5	117
1950	15	1,007
1960	81	3,864
1970	291	7,630
1980	314	28,056
1990	487	236,458
2000	762	229,000
2010	650	289,000
2015	560	116,518

\*Adapted from Hussain and Qasim (1997, p. 866) and the Karachi Stock Exchange

It may be observed that there was a constant rise in the number of listed companies until 2000. However, this number started declining afterwards. This observation supports the arguments presented by Hamid and Kozhich (2007) who asserted that listed companies might have chosen to delist from KSE owing to the cost of financial reporting and restructuring required for ensuring compliance with the Code of Corporate Governance, which was introduced in Pakistan in 2002. However, Israr (2012) argues that the decline in the number of companies might be attributed to the removal of tax benefits offered by the Government to listed companies in 2002. Therefore, the listed companies now have to pay tax at similar rates as non-listed companies but also have to comply with additional regulation. Therefore, many companies decided to delist.

La Porta et al. (1998) argue that the level of investor protection and law enforcement affect the structure of capital market in an economy. They also argue that countries with a common law tradition display a better level of legal protection when compared with civil law countries. La Porta et al. (1998)

further argue that in economies with poor legal protection, capital markets tend to be concentrated.

The case of Pakistan is, however, complex. Pakistan is a common law economy, as historically it was a British colony (Ashraf and Ghani, 2005) and follows an Anglo-Saxon based set of regulations (Ibrahim, 2005). However, in contrast to La Porta et al.'s (1998) argument for strong investor protection in common law countries, law enforcement in Pakistan is quite poor and investor rights are unprotected. Consequently, the stock market in Pakistan is highly concentrated and volatile (Iqbal, 2008; Nawazish and Sara, 2012). For instance, Javid and Iqbal (2010) evaluated the ownership concentration in 60 randomly selected non-financial firms, listed on the Karachi Stock Exchange (KSE), over the period 2003–2007. They found that in those 60 companies, more than 50 per cent of the shareholdings were held by only three shareholders.

### ***Dominance of Family Business***

As discussed in 2.2.1, family relationships have played an important role in shaping business and corporate environment in Pakistan. Family-owned businesses, affiliates of multinational corporations and state ownership are the most common forms of ownership in Pakistan. Hamid and Kozhich (2007) state that the majority of listed companies in Pakistan are family owned. Family ownership is most prevalent in the textile, automotive, tobacco and agriculture sectors. The family-owned business groups prefer to raise capital through internal financing and bank credit, as raising capital through equity finance from market results in weakening their control over firm management (Mumtaz, 2005; Mirza and Azfa, 2010). In a family business, the majority owners attempt to retain control over business activities and closely monitor

management (Mirza and Azfa, 2010). Khan (2014) argued that family members also serve as independent and non-executive directors in most of the family firms.

Mirza and Azfa (2010) further explain that minority shareholder rights remain unprotected in Pakistan under existing legislation. For instance, shareholders with less than a 20 per cent shareholding cannot sue company management in court for negligence. Ashraf and Ghani (2005) have found that the high concentration of ownership in Pakistani firms has made it easier for majority shareholders to expropriate minority shareholder rights.

### **2.4 Corporate Governance and Reporting Regulations**

#### ***Corporate Governance***

The Securities and Exchange Commission of Pakistan (SECP) is the principal regulatory body for corporate sector regulation in Pakistan. The SECP governs the corporate sector through various laws and regulations. The SECP introduced the Anglo-Saxon model of corporate governance through the introduction of a Code of Corporate Governance for the companies listed on the stock exchanges in Pakistan in 2002, while a Code of Corporate Governance for public sector enterprises was later introduced in the year 2012.

The Anglo-Saxon model, largely found in the USA and UK, is a market-based model and is labelled as an ‘outsider’ model of governance (Rwegasira, 2000). This model is based on shareholder theory, whereby corporations are primarily accountable to the shareholders. Following an agency theory perspective (discussed in detail in Chapter 3, Section 3.5.1), this model is suitable for a market characterised by widely dispersed owners, efficient and liquid capital

and equity markets (where firms are expected to be less dependent on long term bank finance), and well established legal systems where company management is relatively free from close monitoring and control. This type of corporate governance model is also characterised by a one-tier (unitary) board structure.

Siddiqui (2010) argues that the Anglo-Saxon model of corporate governance adopted by developing economies (such as India, Bangladesh, South Korea and South Africa) does not represent a suitable model, given the economic, legal and corporate environment of these countries. Siddiqui (2010) explains that stock markets in developing countries are less developed and are characterised by high ownership concentration, whereas the Anglo-Saxon model is more appropriate for implementation in the markets characterised by a low level of ownership concentration and less dependence on bank finance.

However, despite this misalignment, various developing countries, including Pakistan, have adopted this model under the influence of international financial agencies. Javid and Iqbal (2010) point out that Pakistan took technical assistance from the Asian Development Bank for effective enforcement of corporate governance, while the World Bank has provided support in the area of training and development.

The Code has been made a part of the listing regulations of stock exchanges in Pakistan and compliance with the mandatory provisions of the Code is thus binding on listed companies. A checklist outlining the enforcement status of the clauses of the Code is provided as an appendix to the Code. Therefore, all the provisions of the Code are marked as either mandatory or voluntary in that checklist. Hamid and Kozhich (2007) comment that, considering the lack of



awareness regarding corporate governance in the country, the Code was introduced as a ‘comply or explain’<sup>9</sup> document. The regulatory authorities have aims to increase awareness about corporate governance through a relaxed regulatory system. The authorities then intend to introduce a strict/mandatory regulation once the level of awareness with corporate governance has risen.

The business community in Pakistan has resisted the introduction and implementation of the Code of Corporate Governance (The World Bank, 2005). The main barriers identified by businessmen in implementing corporate governance are: (1) the availability of a sufficiently qualified workforce to assist in implementation of the Code; (2) issues related to disclosure of proprietary information to competitors; and (3) a lack of sufficient benefits for compliance (International Finance Corporation, 2007). Hamid and Kozhich (2007) explain that some companies delisted from the Karachi Stock Exchange after the introduction of the Code and suggested that the introduction of the Code of Corporate Governance was the sole reason for their delisting. The main factor contributing towards their delisting was the increased cost of compliance. The companies’ perceive that the printing and publishing of quarterly financial statements and appointment of additional qualified personnel is an extra financial burden. Since the majority of companies in Pakistan are family owned and controlled, companies prefer not to comply with strict regulation aimed at protecting minority shareholder rights (Khan, 2014).

In order to ensure compliance with the mandatory provisions of the Code, the statutory auditors of the company are required to verify the statement of

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<sup>9</sup>Listed companies have to either comply with the provisions of the Code of Corporate Governance or they have to explain the reasons for non-compliance (Ibrahim, 2005) Albu et al. (2015) explained that the purpose of the ‘comply or explain’ principle is to provide flexibility to corporate organisations.

‘compliance with corporate governance’ issued by the board. However, this statement does not confirm the accuracy of the information provided therein.

### ***Financial Reporting and Corporate Governance Disclosures***

In order to meet international reporting standards, Pakistan adopted International Accounting Standards (IAS) voluntarily in 1980. Currently, using a step by step approach, Pakistan is adopting International Financial Reporting Standards (IFRS). As required by Section 234 of the *Pakistan Companies Ordinance* 1984, the SECP is empowered to recommend IFRS. The SECP notifies of the applicability of these standards after consultation with the Institute of Chartered Accountants of Pakistan (ICAP) whereby ICAP is also responsible for their implementation. In addition to these reporting standards, the Code of Corporate Governance of Pakistan incorporates provisions regarding the reporting requirements for companies (Ashraf and Ghani, 2005). Iqbal (2008) argues that the Code of Corporate Governance was introduced in Pakistan for the purpose of ensuring fair trade and transparency in corporate disclosures.

### **2.5 Pakistan’s Institutional Context: Relevance to Other Developing Countries**

Developing countries have not only significantly different institutional environment compared to developed countries, but there are also considerable variations in the institutional conditions of various developing countries across the world (Singh and Newberry, 2008). However, existing researchers have highlighted that some of the developing countries share similarities in terms of the size of capital markets, ownership structures, legal origin, investor protection and political corruption.

Research carried out in Africa indicates that several African countries were British colonies, inherited a common law tradition, characterise ethnic/community affiliation, and display high levels of corruption and poor law enforcement. Rwegasira (2000) argues that capital markets in African countries are small, illiquid and display high levels of ownership concentration, while businesses are mainly dependent on bank financing. These countries have weak legal infrastructure and investor rights are not well protected. For example, see Angaye and Gwilliam (2009) for Nigeria and Soobaroyen and Mahadeo (2008) for Mauritius. It can therefore be argued that the institutional environment prevailing in these countries is comparable with the institutional context of Pakistan.

Similarly, existing literature on regions such as Southeast Asia also recognises the presence of a high level of political corruption, the dominance of family ownership and control, and a high concentration of ownership in the capital markets of these countries (Wu, 2005). The capital market and institutional context in South Asian countries shares remarkable similarities with the institutional context of Pakistan; for example, see Siddiqui (2010) for Bangladesh and Afsharipour, (2009) for India. It may therefore be argued that although this research was conducted in the context of Pakistan, the findings of this research might have limited generalisability to the context of other developing countries which share similar institutional characteristics.

### **2.6 Conclusion**

The foregoing discussion indicates that Pakistan is characterised by the presence of highly concentrated family ownership structures, weak minority shareholder rights and high levels of political corruption. There is a close

linkage between politics and business as most of the well-known politicians are running business empires in the country. The chapter has also provided an account of the introduction of corporate governance regulations in the country. It was also observed that the Code of Corporate Governance encountered resistance from the business community immediately after its introduction. In addition, family controlled companies in the country have also considered reporting and disclosure regulations to be a burden.

In a country with high political interference in business, weak law enforcement and strong family controlled businesses, the study of the reporting practices of listed companies might reveal interesting theoretical and practical considerations. All these factors indicate that Pakistan is an appropriate case for the study of political influence on corporate governance disclosures. In addition, Pakistan's institutional environment shares institutional characteristics prevailing in many other developing countries and the findings of this research might thus be generalisable to other similar contexts. Chapter 3 will provide a comprehensive review of literature on the study of political influence on corporate governance disclosures. The chapter will also highlight the lack of research investigating this academically interesting phenomenon in the context of Pakistan.

## **Chapter 3 – Literature Review and Theoretical Foundations of the Research**

### **3.0 Introduction**

The objective of this chapter is to lay the foundation for this study by presenting the relevant literature on corporate governance disclosure and political connectedness. Section 3.1 begins with a critical review of the existing literature, explaining how various researchers have defined the term ‘political connectedness’ in different contexts. This discussion is followed by an explanation of how the ‘political connectedness’ of the listed companies was measured for this research. Section 3.2 elaborates the distinct nature of political connectedness in developing countries, whereby both the firms and politicians extract benefits from each other through the establishment of political relationships. Section 3.3 provides a critical review of prior literature on corporate governance disclosures. This section also provides an account of existing corporate governance and disclosure research in Pakistan.

Section 3.4 provides a critical analysis of the existing literature on the impact of political connectedness on corporate disclosure. Section 3.5 elaborates the theoretical underpinnings of agency theory and rational choice institutionalism. The theoretical propositions drawn from these perspectives are also stated in this section. The decisions regarding data collection and analysis were then taken on the basis of these theoretical propositions. Section 3.6 summarises the gaps identified in literature review and explains how these gaps will be addressed through this research. Section 3.7 explains how this research makes a significant addition to the existing body of literature through its theoretical as well as methodological contributions. Section 3.8 will conclude this chapter.

**Figure 3.1: Chapter 3 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan’s Institutional Context: Relevance to other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
<b>Methodology Selection</b>	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical considerations</li> <li>– Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The Influence of Political Connectedness on Corporate Governance Disclosures</li> </ul>
<b>Findings and Conclusion</b>	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>

The following section will provide an account of existing literature on the definition of political connectedness. A critical analysis of the existing literature will be provided, following an explanation of how this term is defined for this research project.

### **3.1 Political Connectedness**

Prior research has identified that political influence can be exerted on corporate organisations through political connectedness (Khwaja and Mian, 2005; Faccio, 2006). Several studies on the impact of political influence on business organisations have found that political connectedness brings several benefits for the firms. Boubakri et al. (2012) have found that political connectedness brings the benefit of lower cost of capital for connected firms. Several other studies have found that politically connected firms enjoy the benefit of easy access to financial services (Charumilind et al., 2006; Faccio, 2006; Claessens et al., 2008).

Existing research also provides evidence that firm value and market share/performance are positively related to political connectedness (Fisman, 2001; Goldman et al., 2009; Bunkanwanicha and Wiwattanakantang, 2009). Faccio (2006) argues that political connectedness provides the firms with many benefits such as lighter taxation, lenient regulatory compliance and preferential treatment by government departments.

Researchers in the field of corporate political connectedness have developed various measures for studying this important phenomenon. The following section reviews research on political connectedness in various countries and contexts to understand how it has been defined and measured in by different researchers.

### ***Definition of Political Connectedness***

Various researchers have used different measures for gauging political connectedness across varying contexts. Figure 3.1 provides a summary of various ways in which existing researchers have defined political connectedness. It is noteworthy that the context in which the research is carried out is a key determinant of the method by which political connectedness may be measured.



**Table 3.1: Definition of Political Connectedness in Prior Literature**

<b>Authors</b>	<b>Country</b>	<b>Data Source</b>	<b>Proxy</b>
Xu et al. (2015)	China	China Stock Market & Accounting Research (CSMAR) and the Wind Financial Database (WindDB)	A firm's founder is defined as politically connected if he or she was a former government official, a former military officer, a member of the Committee of the Chinese People's Political Consultative Conference, or a member of the National Congress of Communist Party of China.
Fan et al. (2014)	China	Government publications and internet	Relationship between managers from listed companies and allegedly corrupt bureaucrats
(Peng et al., 2011)	China	Shenzhen GTA Information Technology Corporation, the Beijing Sinofin Information Service, and the Shenzhen Bloomberg Database Corporation.	The firm's CEO or Chairman is a former or current government bureaucrat
Fan et al. (2007)	China	IPO prospectuses of newly listed A-share companies on the Shanghai Stock Exchange and the Shenzhen Stock Exchange from 1993 to 2001	The CEO's (director's) political connections are established by examining whether he or she was currently or formerly an officer of either the central government, a local government, or the military.
Saeed (2013)	Pakistan	OSIRIS and Election Commission of Pakistan (ECP)	The firm having a politician on its board, whereby a politician is defined as an individual who has participated in elections

**Table 3.1: Definition of Political Connectedness in Prior Literature**

<b>Authors</b>	<b>Country</b>	<b>Data Source</b>	<b>Proxy</b>
Khwaja and Mian (2005)	Pakistan	Credit Information Bureau (CIB) database at the State Bank of Pakistan (SBP) and election data, Election Commission of Pakistan (ECB)	The firm having a politician on its board, whereby a politician is defined as an individual who has participated in elections
Braam et al. (2015)	Cross country study	Dataset used by Faccio (2006) and Worldscope Database	If at least one of the firm's large shareholders (anyone controlling at least 10% of voting shares) or one of the top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or closely related to a top politician or party
Chen et al. (2010)	Cross country study	The Global Vantage and International I/B/E/S databases	A company is identified as being connected with a politician if at least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party
Faccio and Parsley (2009)	Cross country study	DataStream Worldscope <a href="http://www.politicalgraveyard.com">www.politicalgraveyard.com</a>	Firms are regarded as connected if their headquarters are located in the home town of the deceased politician (city where politician resided).

**Table 3.1: Definition of Political Connectedness in Prior Literature**

<b>Authors</b>	<b>Country</b>	<b>Data Source</b>	<b>Proxy</b>
Faccio (2006)	Cross country study	Official web site of each country's government and parliament, Worldscope	A company is identified as being connected with a politician if at least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party
Civilize et al. (2015)	Thailand	Stock Exchange of Thailand and Business Online website which has a license from The Ministry of Commerce of Thailand to deal with information on Thai listed companies	A 'politically connected firm' is defined as any firm that: (1) has a politician or a family member of a politician sitting on the board of directors, either as an executive, or non-executive director; or (2) has a politician, a family member of a politician, or any private entity ultimately owned by him/her, as a major shareholder during the study period
Bandeira-de-Mello et al. (2012)	Brazil	The Economatica database	Political donations

**Table 3.1: Definition of Political Connectedness in Prior Literature**

<b>Authors</b>	<b>Country</b>	<b>Data Source</b>	<b>Proxy</b>
Menozzi et al. (2012)	Italy	Electronic databases such as FACTIVE, LEXIS-NEXIS, ABI Inform (press release), and the Who's Who in Italy. Most of the information was found on the Internet.	Firms having directors on the boards who had a record for present or past activity in the political arena
Jayachandran (2006)	United States	Centre for Research on Security Prices (CRSP) Federal Election Commission	Political donations
Khemakhem and Dicko (2013)	Canada	OSISRIS data base, Sedar.com. and SEDAR database	At least one of the firm's directors is or has been a member of parliament, works for the government, belongs to a political party or has made a financial contribution to a political party
Fisman (2001)	Indonesia	Suharto Dependency Index Financial Times Extel Financial Database	Suharto Dependency Index rated the level of political connectedness on the basis of strength of relationship with Suharto and his children.

Table 3.1 shows that, in the context of China, Fan et al. (2014) identified 45 cases of corruption from 1996–2007. They identified all those companies that were located within the province or city administered by the allegedly corrupt bureaucrats involved in these corruption cases. In order to determine political connectedness, Fan et al. (2014) searched government publications and the Internet for news about relationships between managers in those listed companies and the allegedly corrupt bureaucrats. A company was considered as politically connected if Fan et al. (2014) found a news item confirming that the senior managers, directors or major shareholders of that company had allegedly bribed one of these bureaucrats.

The determination of political connectedness using this criterion can be criticised on various accounts. Firstly, it might be argued that the assumption that political connections are jurisdiction (location) based is flawed. Thus, some of the bureaucrats may be connected to the companies located in other provinces and cities. Secondly, the credibility of online news and media reports might be questioned being that no explanation was provided as to which particular online news portals were used for research. Concerns may thus be raised regarding the trustworthiness of the data obtained from the Internet.

In another research project carried out by Fan et al. (2007) in China, a CEO was defined to be politically connected if he/she was currently or had formerly been an officer of either the central government, local government or the military. This measure has also been used by (Xu et al., 2015). Peng et al. (2011) have also used a similar measure, considering a firm connected if the CEO or chairman was a current or former government employee.

These measures are suitable for measuring political connectedness in China, considering the strong government control and influence over the corporate sector. However, it might be argued that these measures are not ideal for measuring political connectedness in Pakistan because the level of state intervention and control over corporate sector in Pakistan is significantly less compared to China.

Table 3.1 also shows that political donations have been used as a measure for identification of political connectedness in the United States and Brazil (Jayachandran, 2006; Bandeira-de-Mello et al., 2012). However, being that firms do not publically disclose data on their political contributions in Pakistan, this measure of political donations is not suitable for determining political connectedness in Pakistan's context.

Fisman (2001) used the Suharto Dependency Index developed by the Castle Group for the identification of political connectedness in Indonesia. The Suharto Dependency Index provides subjective ratings of the extent to which the top 25 business groups in Indonesia depend on political connectedness for increased profitability. The firms are rated on a scale ranging from one to five, depending on the strength of their political connectedness. For example, a score of five is assigned to a firm that is affiliated to Suharto's children. This measure of political connectedness has been quite useful for the purpose of the study in the context of Indonesia. However, such a measure cannot be used for determining political connectedness in Pakistan being that no such index has been prepared for Pakistan (Saeed, 2013).

Several researchers have used the political affiliation of the members of corporate boards as a measure for political connectedness in cross-country

studies. Faccio (2006, p. 369) describes a firm as politically connected if one of its largest shareholders (controlling at least 10 per cent of voting shares) or one of its executive officers (its CEO, president, vice-president, chairman or secretary) was a member of parliament, a minister, or was closely related to a senior politician or party. This measure has also been used by various other researchers (Chen et al., 2010; Braam et al., 2015). However, it limits the analysis of political connectedness to CEO, president, chairman and secretary of the firms as political influence transmitted through politically connected members of the board is not taken into account.

Khemakhem and Dicko (2013) have overcome this limitation of excluding board members and included politically connected members of the board of directors while measuring firms' political connectedness. Thus a firm is considered to be politically connected if at least one of the firm's directors has served as a member of parliament, has worked for the government, is or was a member of a political party or has made contributions to a political party.

Faccio and Parsley (2009) argue that location is an important determinant of political connectedness. They consider companies to be politically connected if they have headquarters located in the town of birth or residence of a politician. Such a measure might also be criticised on numerous grounds. Several firms might be operating in a single town/jurisdiction/city, however all of them cannot be considered to be politically connected. The definition of the term 'location' is also quite problematic as it may refer to a varying range of possibilities, such as a village, city, constituency or province. Moreover, under this definition, the status of the political connectedness of a firm will remain

unchanged even in the case of change of ownership, directors or management, merely because the firm's headquarters is situated in a particular location.

Menozzi et al. (2012, p. 7) define politically connected firms as firms having directors on the boards who have a record for present or past activity in the political arena. They consider a firm to be politically connected if the directors on its board hold a political position or membership to a political party, or have participated in an election.

Khwaja and Mian (2005) investigated the influence of political environment on bank lending practices in Pakistan. They define a firm as politically connected if it has politicians on its board; here, a politician is defined as an individual who has participated in elections. This measure of political connectedness has been used for this research project because it allows for the measurement of connectedness at individual firm level. This definition of political connectedness takes into account the presence of current and former politicians, based on the argument put forward by Boubakri et al. (2008) that politicians remain capable of extracting benefits even when they are not in power. That is, ex-politicians have often been found to obtain easy access to loans, preferential treatment and resources.

Saeed (2013) argues that there are several difficulties associated with the determination of political connectedness in developing countries such as Pakistan. Saeed (2013) asserts that determining the political connectedness of a firm requires the researcher to establish linkages between the firm and governmental bodies. Prior literature argues that companies are often reluctant to disclose their political connectedness as this information is considered to be of a sensitive and proprietary nature (Baines and Viney, 2010). Meanwhile,



discussion of the existence of political relationships is considered a taboo subject in the business environment of developing countries, such as Pakistan (Saeed, 2013). In addition, the nature of these relationships is volatile and can be subject to a noticeable shift over time.

Saeed (2013) also studied the influence of political connectedness on non-financial listed firms in Pakistan. This study explored the impact of political connectedness on firm's performance and the ability to access finance. The results of the study indicate that political connectedness is positively related to a firm's ability to access finance, although it negatively influences the firm's performance. Saeed (2013) also used the same measure to determine the political connectedness of listed companies in Pakistan; that is, the one used by Khwaja and Mian (2005). Here it is argued that this measure is most appropriate in consideration of Pakistan's political and institutional context.

A detailed explanation regarding the selection of the research sample and the process of data collection is provided in Chapter 4, Section 4.2.1. The following section explains the importance of corporate political connectedness with reference to developing countries.

### **3.2 Political Connectedness in Developing Countries**

Politics can influence the owners, size, structure, profitability, financing avenues, culture and operations of a firm (Roe, 2003). Wu (2005) argues that politicians take an interest in corporate organisations as they extract benefits and bribes from the corporate sector. On the other hand, the existing literature also recognises that corporate organisations develop political connections strategically for the purpose of seeking rents, obtaining preferential treatment and subsidies, reduced taxation, obtaining access to land and utilities and

extracting other undue benefits. Therefore, the connection between politicians and firms yields mutual benefits for both parties (Shleifer and Vishny, 1994; Macey, 2014; Domadenik et al., 2014; Fan et al., 2014).

The nature and prevalence of political connectedness is distinct in developing economies (Desai, 2011; Saeed, 2013). In developing countries, the capital markets lack sufficient institutional resources to support entrepreneurs (Domadenik et al., 2014). Business owners often face difficulties in obtaining access to various facilities, such as bank finance, land, services from public organisations, while they also have to follow excessive regulation (Desai, 2011). As key state resources are held by government, business organisations tend to develop relationships with politicians. Thus, political connections facilitate access to the resources required on the part of these business organisations (Li et al., 2008; Xu et al., 2013).

Xin and Pearce (1996) argue that, in the absence of a strong judicial system, people hesitate to trust one another. In such circumstances, legal contracts are not deemed enforceable. Thus, in order to protect their interests, people tend to establish relationships and political connections to serve as a substitute for a strong legal infrastructure. Bushman et al. (2004) claim that, in countries with weak law enforcement, relationship-based arrangements and private mechanisms for enforcement of contracts will emerge. As contract enforcement mechanisms are weak, parties to a contract develop informal ties with each other. These informal ties serve as a substitute for the strong enforcement of contracts.

Owing to poor law enforcement, firms avoid dispersal of equity to outsiders and outside investors also lack the necessary confidence for investing money in

the equity market. The resulting equity markets are thus highly concentrated with greater emphasis placed on personal relationships. Bushman et al. (2004) further argue that in order to meet their political agenda, politically powerful elites favour their acquaintances in return for bribes, political support and nepotism. Leuz and Oberholzer-Gee (2006) also argue that, in countries characterised by weak law enforcement, economic transactions are made on the basis of close personal ties and political relationships, while political influence plays a significant role in shaping corporate governance systems.

The extent of political connectedness is also relevant to the level of corruption in an economy (Bertrand and Schoar, 2006; Faccio, 2006; Goldman et al., 2009). Fisman (2001) argues that a high level of corruption in developing countries such as Pakistan, China, India and Bangladesh might indicate the existence of a higher level of political corruption and rent-seeking through political connectedness. Faccio (2006) and Boubakri et al. (2008) argued that the political connectedness of firms is predominant in countries which exhibit lower judicial independence. Faccio and Parsley (2009) also found that politically connected firms are more prevalent in countries with high levels of corruption and weak legal systems.

Berglof and Thadden (1999) argue that, in most developing countries, business organisations are characterised by the dominance of family ownership structures. Berglof and Thadden (1999) further argue that the owners of these family-held businesses are normally politically influential people. Bertrand and Schoar (2006) argue that family firms are in a better position to develop and maintain political relationships through kinship and networking. These politically influential people often succeed in influencing the development and

implementation of laws and regulations in such countries (Berglof and Thadden, 1999).

Being that political relationships are an important feature of business in developing countries such as Pakistan, the study of the influence of political connectedness on corporate activities is particularly important. The existing literature recognises that political influence is the reason why certain laws remain in place in developing countries, irrespective of their enforceability or usefulness. Agrawal and Knoeber (2001) and Bunkanwanicha and Wiwattanakantang (2009) found that politically connected firms use political influence for the implementation and adaptation of favourable economic policies and regulations in developing countries having weak legal infrastructure. Hellman et al. (2000) supply evidence to suggest that firms influence the legal systems and policy-making process through the exercise of political influence.

In addition, the value of political connections in developing countries increases because these economies are mainly dependent on bank finance. Several factors are considered to have an influence on financing decisions by banks; for example, trust (Moro and Kodwani, 2010), political relationships (Khwaja and Mian, 2005), social responsibility practices (Cheng et al., 2014), etc. In the absence of formal mechanisms of governance (such as a strong legal system), social systems (such as political connectedness) are developed to carry out economic and financial transactions such as bank loans (Charumilind et al., 2006). Consequently, in such countries politically connected firms commonly obtain better access to finance (Claessens and Perotti, 2007). Therefore, it can

be argued that the nature and value of political connectedness is manifold in developing economies.

Political influence is recognised to be the most significant factor in bank financing decisions in Pakistan. Khan and Bhatti (2008) have documented the impact of direct political influence on the presidents of banks in regard to the sanction of loans to politically influential people. Such borrowers have later defaulted and the loans have never been recovered.

Khan and Bhatti (2008) argue that the State Bank of Pakistan has a poor corporate governance system and the financial sector of Pakistan has been severely abused by politically influential elites. Saeed et al. (2014) indeed find a positive relationship between a firm's leverage and its political connectedness. Saeed (2013) also studied how political connectedness affects a firm's ability to raise finance, and found that politically connected firms enjoy the benefits of preferential lending. Saeed (2013) also investigated the impact of political connectedness on firm performance and found negative relationships to be prevalent.

Meanwhile, Khwaja and Mian (2005) investigated the influence of political connections in the financial sector of Pakistan. They found that public sector banks are subject to heavy political influences, being that politically connected firms borrowed 40 per cent more from public sector banks, while the default rate of the loans extended to politically connected firms was 50 per cent higher when compared to the default rate for non-connected firms. The authors further assert that in contrast to public sector banks, private banks are not subject to high political pressures.

As discussed earlier in Chapter 2, Pakistan is a developing country with weak law enforcement and high levels of corruption (Easterly, 2001; Anwar, 2006). The World Bank (2005) has reported that the Securities and Exchange Commission of Pakistan (SECP), which is responsible for the formulation and implementation of all corporate policies and regulations for corporations operating in Pakistan, itself operates under political influence. Furthermore, the substantial involvement of political dynasties in the corporate sector (discussed in detail in chapter 2) renders Pakistan to be an ideal case for the study of the impact of political connectedness on corporate disclosure.

Nonetheless, there is a lack of research on the influence of political connectedness on the disclosure practices of listed companies. To the best of the researcher's knowledge, no research has so far focused on investigating the impact of political connectedness on the corporate governance disclosure practices of listed companies in Pakistan. This research will thus fill this gap in the literature, while the research findings may also be generalisable in the developing countries which have a similar institutional context to Pakistan.

### **3.3 Corporate Governance and Disclosure Practices**

Corporate governance and disclosure are considered to be highly interlinked concepts. Transparency of corporate information is an important aspect of corporate governance. Corporate governance ensures transparency in corporate disclosures through the introduction of such mechanisms as reporting and disclosure regulations (Qu and Leung, 2006; Melis and Carta, 2010; Ștefănescu, 2012a). On the other hand, disclosure requirements are considered to be an important mechanism used by regulators to enhance corporate

governance, being that they ensure managers are managing the affairs of the firm in an effective and transparent manner.

Several researchers have argued that level of corporate disclosure increases with the introduction of mandatory disclosure regulations (Owusu-Ansah and Yeoh, 2005). Therefore better transparency in a firm is related to superior corporate governance mechanisms (Green and Graham, 2005). According to the corporate and financial reporting framework provided in the Code of Corporate Governance (2002), the purpose of corporate disclosure requirements is to ensure that the financial statements present a fair picture of the actual affairs, where proper books of accounts are maintained, appropriate and consistent accounting policies are applied and any concerns are explicitly stated about a company's ability to continue business as a going concern.

Financial scandals, such as that of Enron, have highlighted the need for greater accountability and transparency and raised concerns about the practices of corporate boards and managerial misconduct. Subsequent to these scandals, disclosure and reporting requirements received extensive attention throughout the world. The reports of the various commissions, such as Treadway (1987) in the USA and Cadbury (1992) in the UK highlighted the importance of better corporate governance for improving corporate transparency (Green and Graham, 2005; Lin et al., 2014). Ineffective corporate governance practices accompanied by unreliable financial reports have been considered a major reason for a lack of investor confidence (Rezaee, 2004), poor accounting practices and weak internal control mechanisms (Uwuigbe et al., 2014).

Bujaki and Mcconomy (2002) argue that firms running into corporate governance failures disclose a poor quality of corporate governance

information prior to such failure. Thus, the literature on corporate governance disclosure recognises that good corporate governance and disclosure are important mechanisms for ensuring transparency in corporate affairs, preventing frauds, and safeguarding against corporate failures. This is a significant concern for international regulatory bodies, as well as academic researchers in the area of corporate governance disclosure, and has therefore served as an important motivation for this research.

As existing research has affirmed, the board of directors is the holder of managerial powers in Anglo-Saxon countries (Heracleous and Lan, 2012). The board holds a central position in corporate governance system (Daily et al., 2003). However, accessing the members of the board has been recognised as a difficult task by researchers. Hence accounting for what actually happens in board meetings remains under-researched (Leblanc and Schwartz, 2007; Payne et al., 2009). Green and Graham (2005) assert that corporate disclosures provide a source of information in regard to the decisions taken during the meetings and the strategies of the board as they are prepared under the advice of the board (Matoussi and Chakroun, 2008).

Haniffa and Cooke (2002) claim that annual reports are prepared by chief accounting officer of the companies. In order to understand the actual process behind the preparation of annual reports in the context of Pakistan, this research aims to investigate who makes decisions regarding the preparation and disclosure of corporate governance information in annual reports.

The following section will provide a critical overview of the existing literature on corporate governance disclosure.



### **3.3.1 Review of Literature on Corporate Governance Disclosure**

Bhasin (2012) defined corporate governance disclosure as the provision of governance related information to the stakeholders of corporate organisations. It is important to clarify here that ‘corporate disclosure’ is a broad term that collectively covers disclosure in the various aspects of corporate communication (Akhtaruddin et al., 2009; Ta Quang, 2012; Chakroun, 2013). However, a diverse body of literature exists on each of the aspects of corporate disclosure; for example, environmental disclosure (da Silva Monteiro and Aibar-Guzmán, 2010; Salama et al., 2012), corporate social responsibility disclosure (Khan et al., 2013; Jizi et al., 2014; Chan et al., 2014), disclosure on a company’s intellectual capital (Jing et al., 2008; Hidalgo et al., 2011; Dumay et al., 2015), information on human resources (Vuontisjärvi, 2006; Ullah et al., 2015), corporate governance disclosures (please refer to the following section for a detailed review), disclosure on forward looking information (Kent and Ung, 2003; Beretta and Bozzolan, 2008), and disclosure on corporate risk practices (Uddin and Hassan, 2011; Rodríguez Domínguez and Noguera Gámez, 2014; Al-Najjar and Abed, 2014) etc. However, this research focuses on the analysis of corporate governance disclosures.

Various researchers have studied corporate governance disclosure from different perspectives. Table 3.2 provides a summary of the literature review carried out in this research. The table provides information about the various determinants of corporate governance disclosure as identified by prior literature.

**Table 3.2: Review of Relevant Literature–Determinants of Corporate Governance Disclosure**

Authors	Country	Theory	Type of Analysis	Variable with a Significant Effect		Variable without a Significant Effect
Al-Najjar and Ding (2014)	United Kingdom	Agency theory	Regression models	Industry competition Board independence Audit committee independence	+ + +	
Sharma (2014)	Nepal	Agency Theory	Multiple regression	Size Leverage Foreign Association	+ + +	Profitability Listing age
Bhasin (2012)	India	Information assymetry	Content analysis	Size	+	Industry type
Desoky and Mousa (2012)	Egypt	Agency theory	Univariate Analysis Multivariate Analysis	Foreign listing Firm size Audit Firm	+ + +	
Samaha et al. (2012)	Egypt	Agency theory	Multiple regression	CEO duality Ownership concentration Firm size Number of independent directors	- - + +	
Stefănescu (2012a)	United Kingdom	Agency Theory	Multiple Regression	CEO Duality Number of independent directors	- +	
Stefănescu (2012b)	United Kingdom	Agency theory	Multiple regression	Existance of Board committees Independence of board committees	+ +	
Muhamad et al. (2009)	Malaysia	Agency theory Stewardship theory	Multivariate test	Size Leverage Industry	+ + +	Board composition Profitability Auditor

**Table 3.2: Review of Relevant Literature–Determinants of Corporate Governance Disclosure**

Authors	Country	Theory	Type of Analysis	Variable with a Significant Effect		Variable without a Significant Effect
Gandia (2008)	Spain	Agency theory	Multiple Regression	Intention to raise equity capital Level of analyst following Duration of company in Stock exchange Firm size Sector	+ + - + +	Board size CEO-Chairman duality Free float Size of Audit firm
Hossain (2008)	India	Agency theory	Multiple regression	Size Public Ownership Board composition Financial Performance	+ - + +	Age Complexity of Business Dividends Multiple listing Number of Auditors
Hussainey and Al-Nodel (2008)	Saudi Arabia	-	Content analysis	Sector Government involvement in business	+ -	
Maingot and Zeghal (2008)	Canada	Isomorphism	Content analysis	Webpage as a medium of disclosure Size	- +	
Ben-Amar and Boujenoui (Ben-Amar and Boujenoui, 2006)	Canada	Agency theory	Univariate analysis Multivariate analysis	Inside ownership CEO duality Board independence Firm size Cross-listing	- - + + +	Management ownership

**Table 3.2: Review of Relevant Literature–Determinants of Corporate Governance Disclosure**

<b>Authors</b>	<b>Country</b>	<b>Theory</b>	<b>Type of Analysis</b>	<b>Variable with a Significant Effect</b>		<b>Variable without a Significant Effect</b>
Andersson and Daoud (2005)	Sweedon	Agency theory	Linear regression Multiple regression	Role duality Existence of an audit committee Number of shareholders Board compensation Existence of a compensation committee Corporation size Multiple listings	+	Management ownership Proportion of non-executive directors Larger audit firms Diffuse ownership Board size Board ownership Existence of nomination committee Board activity Industry type
Green and Graham (2005)	Canada	Disclosure theory, discourse analysis, and structuration theory	Discourse analysis	Strict regulation	+	
Collett and Hraskey (2005)	Australia	Information asymmetry	Multivariate Analysis	Intention to raise capital finance Intention to raise debt finance Industry classification Multiple stock listing Firm performance	+ - + + +	

**Table 3.2: Review of Relevant Literature–Determinants of Corporate Governance Disclosure**

<b>Authors</b>	<b>Country</b>	<b>Theory</b>	<b>Type of Analysis</b>	<b>Variable with a Significant Effect</b>		<b>Variable without a Significant Effect</b>
Bujaki and McConomy (2002)	Canada	Isomorphism Disclosure management theory	Multivariate analysis Simultaneous Equations analysis	Intention to raise capital Size Revenue Unrelated directors Leverage	+ + - + +	

The following sections provide a critical review of the existing literature on corporate governance disclosure.

### ***Regulation and Corporate Governance Disclosure***

Several researchers have studied the level of corporate governance disclosure in the corporate communication of listed companies. Sharma (2014) analysed the extent of voluntary and mandatory corporate governance disclosures in the annual reports of 59 banking and financial companies in Nepal for the year 2010. A disclosure index was constructed and the results of the study indicated that companies were disclosing information on 91 per cent of the mandatory items, while the level of disclosure for voluntary disclosure was 48 per cent. Thus the companies have been providing a significantly higher level of mandatory information on governance practices when compared with voluntary information. It might thus be inferred that corporate governance disclosure increases when it is made mandatory for companies to disclose information and companies do not tend to disclose information voluntarily.

Green and Graham (2005) studied the voluntary corporate governance disclosure practices of the 35 largest companies listed on Toronto Stock Exchange as at 11 May 2011, analysing the annual reports and proxy circulars of these listed companies for the years 2000 and 2002. Voluntary disclosure in regard to board accountability, independence and directors' roles, responsibility and inter-relationships was examined using discourse analysis. In the analysis performed for the year 2000, it was found that these companies provided poor disclosure, while information on key aspects of governance was omitted. The information provided in these documents lacked clarity, consistency and explicitness.

However, in the annual reports and proxy circulars for 2002, Green and Graham found a better level of disclosure in comparison with 2000. They concluded that a culture of voluntary disclosure was developing on the Toronto Stock Exchange and that there was no need for strict disclosure regulation. This was a very useful study from the perspective of the analysis of corporate governance information in annual reports. The study focused on an in-depth analysis of narratives in annual reports. Moreover, instead of using quantitative techniques for the analysis of given disclosures, the focus was on the analysis of omitted information.

Qu and Leung (2006) argue that corporate disclosure consists of financial disclosure and corporate governance disclosure. Qu and Leung thus developed an index for corporate governance disclosure and classified corporate governance information in eight broad categories. They analysed corporate governance disclosures in the annual reports of 120 Chinese listed companies from 19 industries for the year 2003. They found that 104 companies disclosed corporate governance information voluntarily. They observed that 85 per cent of the Chinese listed companies provided voluntary information regarding corporate governance in annual reports. The researchers themselves recognised the small sample size to be a limitation of this study. However, as the size of the sample was small, this study might also be criticised on the grounds of lacking depth in the analysis performed.

Gandía (2008) examined corporate governance disclosures in the annual reports and websites of listed Spanish companies. The study revealed that listed companies provided a low level of corporate governance information. In addition, only 20 per cent of the companies disclosed a good level of disclosure

on company websites, while the rest of the companies did not provide adequate online disclosure.

Bhasin (2012) studied the voluntary disclosure practices of 50 companies for the years 2003–2004 and 2004–2005 from four different industries in India. He analysed voluntary disclosure practices of listed companies through the development of a disclosure index. Descriptive statistics were then applied for analysis of data. It was found that companies were disclosing a poor level of information about their corporate governance practices. This study did not use any sophisticated statistical tools for the analysis of data and the sample size was also small. Therefore, the results of the study cannot be generalised. In addition, despite a small number of annual reports, an in-depth analysis of disclosures was not carried out, meaning that the analysis lacked depth as well as breadth.

### ***Corporate Governance Disclosure and Capital Financing***

Several researchers have examined the relationship between voluntary corporate governance disclosure and the intention to raise external finance. Bujaki and McConomy (2002) examined the annual reports of 290 companies listed on the Toronto Stock Exchange for the year 1997. They applied multivariate analysis and found that the firms intending to raise capital in the future disclose more information in annual reports. However, the companies that do not intend to raise capital use less expensive means of disclosure, such as management information circulars.

Collett and Hrasky (2005) examined data for 29 companies listed on the Australian Stock Exchange for the year 1994. They used the data for year 1994 being that they wanted to study voluntary disclosure practices of listed



companies before corporate governance regulations were introduced in the Australian Stock Exchange. They ran a regression analysis and found an association between firms' intentions to acquire finance and their voluntary corporate governance disclosure practices. It was found that companies intending to raise capital through equity financing provide better disclosure compared with the companies that intend to raise capital through debt financing. Although this study used quantitative techniques for data analysis, the sample used for this research was too small for a quantitative study, representing a major weakness in this research. Gandía (2008) studied corporate governance disclosures in Spanish companies and found that Spanish companies provide higher disclosure for attracting investors.

#### ***Corporate Governance Disclosure and Size***

Sharma (2014) found that there is a significant relationship between the size of the company and the level of corporate governance disclosure in its annual reports. He argued that big<sup>10</sup> companies possess the necessary resources required to finance the costs of disclosure. In addition, large firms are more visible and thus accountable to a larger number of stakeholders, thus providing more disclosure to meet the information needs of these stakeholders. Ben-Amar and Boujenoui (2006) also found a positive relationship between firm size and the level of disclosure.

Maingot and Zeghal (2008) analysed the corporate websites, annual reports and proxy circulars of eight Canadian banks and found that large banks disclosed more information on their websites, while smaller banks disclosed more governance information in their annual reports. They assert that the size of an

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<sup>10</sup> Sharma (2014) considered a company to be 'big' if the value of its assets exceeded 20,000 million (Nepali Rupees.)

organisation can influence its disclosure practices. The coding sheet developed by Maingot and Zeghal (2008) was quite elaborate and it was used as a guide for initial coding of the data in this research. However, the results from Maingot and Zeghal (2008) were based on regression analysis carried out on a small sample of 38 listed Indian banks for the year 2003. The small sample size points to limitations regarding generalisation of these results. Hossain (2008) also found that the size of a firm is positively related to the level of mandatory corporate governance disclosures.

Muhamad et al. (2009) studied the factors affecting the quality and quantity of voluntary as well as mandatory disclosure in the annual reports of listed companies in Malaysia. They found that the size of the company is positively related to the level of corporate governance disclosure in its annual report, being that large companies provide more information in annual reports for the purpose of managing how they are perceived by the public. Desoky and Mousa (2012) studied the disclosure practices of 100 listed companies in Egypt and found that firm size is positively associated with the level of corporate governance disclosure in the annual reports and company websites.

In turn, Andersson and Daoud (2005) studied the relationship between corporation size and the level of corporate governance disclosure in the annual reports of 54 companies listed on the Stockholm Stock Exchange for the year 2003. They found a positive relationship and argued that larger companies disclose more information as it facilitates their dealings with government agencies, the public and investors. Good disclosure also helps to build a better reputation for these companies.

It might be inferred that the existing research indicates the presence of a positive relationship between the size of the firms and the level of disclosure. However, the study of this relationship does not fall within the scope of this research. All the companies studied in this research are medium-sized firms. Therefore, the size of these firms will not be an influential factor for examining variations in the level of disclosures.

#### ***Corporate Governance Disclosure and the Audit Firm***

Existing research has also questioned the impact of the size and number of audit firms (more than the minimum statutory requirement at one point in time) on the transparency of corporate reporting. However, the research in this regard presents contradictory results. Desoky and Mousa (2012) studied the disclosure practices of 100 listed companies in Egypt and found that the size of the audit firm is positively associated with the level of corporate governance disclosure in the annual reports and company websites. They argued that bigger audit firms possess the experience and expertise necessary to convince company management to provide higher levels of disclosure.

On the other hand, Andersson and Daoud (2005) found that the size of the audit firm does not influence the level of corporate governance disclosure. Hossain (2008) also studied the influence of the number of audit firms on mandatory corporate disclosure practices of listed banks. Here he found that the number of auditors does not have any significant impact on the level of disclosure in annual reports.

Being that it is standard for statutory audit firms in Pakistan to issue a review report regarding corporate governance and disclosure practices of listed companies, their role is particularly important in the context of Pakistan. For

the same reason, this research has also interviewed the representatives of statutory audit firms. In addition, review reports from statutory auditors have also been analysed for the purpose of exploring any differences in the corporate governance disclosures provided in the audited annual reports of politically connected and non-connected firms.

#### ***Corporate Governance Disclosure and Industry***

Prior research on the influence of industry type on corporate governance disclosure has provided contradictory evidence. Several researchers have argued that disclosure practices across various industries might vary. The reason for this variation might be traced in the difference in stakeholders' expectations and regulatory disclosure requirements across industries (Toms et al., 2007; Muhamad et al., 2009; An et al., 2011). Al-Najjar and Ding (2014) studied corporate governance disclosure practices of 162 FTSE firms from the UK from 2001 to 2009. The results of the panel data analysis revealed that companies in less competitive industries<sup>11</sup>, those with high entry costs and large market size, make better corporate governance disclosure.

Collett and Hrasky (2005) argued that the firms in politically visible industries provide better voluntary disclosures because it positively contributes in managing their reputation. Collett and Hrasky (2005) studied the relationship between corporate governance disclosures and industry classification. Using the technique of multinomial regression analysis on 29 annual reports of Australian companies, they found that the companies in resource industries disclosed better quality corporate governance information than the companies

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<sup>11</sup> Al-Najjar and Ding (2014) consider those industries as less competitive where entry cost was high and market size was large.

in other industries. However, the small sample size is a major limitation of this study.

Andersson and Daoud (2005) also studied the relationship between industry type and corporate governance disclosure but found no association. However, Andersson and Daoud (2005) clarified that their classification of industries was not well developed, being that they included firms carrying out significantly different nature of business into a single industry type. The results of the study might therefore be problematic.

Hussainey and Al-Nodel (2008) used the technique of content analysis for the analysis of corporate governance information provided on the corporate websites of 64 Saudi listed companies across eight industries. They found that banks disclosed the highest level of information, while companies in the industry and service sectors provided minimum disclosure. They then argue that banking institutions provide higher level disclosure being that the banking industry is highly regulated and the sector is required to provide more disclosure to the public. Muhamad et al. (2009) found that companies in the infrastructure industry<sup>12</sup> provides a higher level of voluntary as well as mandatory information in the annual reports.

However, several researchers have argued that the type of industry does not influence corporate governance disclosure. Bhasin et al (2012) studied the voluntary corporate governance practices of listed companies across four industries in India and found that there were no differences in the level of disclosure across these industries. Andersson and Daoud (2005) also found that

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<sup>12</sup>Muhamad et al. (2009) have not provided any further information on the nature of industry.

industry type does not influence the disclosure of corporate governance information in the annual reports of Swedish listed companies.

A review of the relevant literature indicates that the industry/sector of a listed company might have an influence on the disclosure practices of listed companies. In order to become aware of industry influence, listed companies from a number of different sectors have been examined; that is, sugar, textile, chemical, food, leather, packaging, construction, paper, wool, synthetic products and miscellaneous. It is important to note that no study in Pakistan has examined the influence of industry type on corporate governance disclosures to date. This research fills the current gap in the literature.

#### ***Corporate Governance Disclosure and Board Attributes***

Bujaki and McConomy (2002) studied the voluntary corporate governance disclosure practices of 290 companies listed on the Toronto Stock Exchange for the year 1997. They found that the companies with more unrelated<sup>13</sup> members of the board provide more voluntary corporate governance information. Samaha et al. (2012) studied the impact of various corporate governance mechanisms on voluntary corporate governance using regression analysis and found that the level of corporate governance disclosure is negatively related to CEO duality<sup>14</sup>. They also found that the level of corporate governance disclosure is positively related to the number of independent directors on the board.

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<sup>13</sup>Bujaki and McConomy (2002, p. 107) defined an unrelated director as “a director who is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director’s ability to act with a view to the best interests of the corporation, other than interests and relationships arising from shareholding.”

<sup>14</sup>Samaha et al. (2012) explained that CEO duality refers to the situation when the positions of Chief Executive Officer and Chairman of the board are held by the same person, and at the same time.

Stefănescu (2012a) studied how CEO duality affected the disclosure of corporate governance information in the annual reports and websites of 46 banks listed on the London Stock Exchange for the year 2011. The results of linear regression revealed that CEO duality negatively affects corporate governance disclosures. Ștefănescu (2012b) also investigated the impact of existence and independence of board committees on corporate governance disclosure. Here, a positive relationship was found in the results of linear regression.

Hossain (2008) researched the impact of board composition on mandatory corporate governance disclosure in the annual reports of 38 listed Indian banks for the year 2003. Regression analysis was used to determine this relationship and it was found that the number of independent directors is positively related to the level of corporate disclosure. Ben-Amar and Boujenoui (2006) found a positive statistical relationship between board independence and corporate governance disclosure in 587 Canadian listed companies over the period 2002–2004. Al-Najjar and Ding (2014) also found a positive relationship between board independence and the level of corporate governance disclosure.

Andersson and Daoud (2005) also studied the impact of various board attributes, such as CEO duality, board size, board compensation, the existence of a compensation committee, the existence of a nomination committee, an audit committee and the activity of the board. Multiple regression analysis was used to determine the relationship between these characteristics and the quality of corporate governance disclosure. Contrary to the results of previously mentioned studies, the results of the study indicate that the level of disclosure is positively related to CEO duality, the presence of an audit committee and the

presence of a nomination committee. However, these findings might be criticised as companies having role duality in the sample had foreign owners. Andersson and Daoud (2005) also acknowledge that differences in ownership structure were not taken into account when their analysis was carried out. Furthermore, Andersson and Daoud (2005) also found that the size of the board, proportion of non-executive members on the board, existence of nomination committee and board activity did not have any influence on the level of corporate governance disclosure.

#### ***Ownership Structure and Corporate Governance Disclosure***

Samaha et al. (2012) found that the level of corporate governance disclosure decreases with an increase in ownership concentration. Bauwhede and Willekens (2008) analysed data from 130 firms from the FTSE Eurotop 300 using regression analysis and found that ownership structure affects the level of voluntary corporate governance disclosures, while higher ownership concentration results in poor corporate governance disclosure. Bauwhede and Willekens (2008) argue in turn that a separation of ownership and control results in better corporate governance disclosure.

Hossain (2008) found that publicly owned banks provide less mandatory corporate governance disclosure compared to private banks. Hossain (2008) explained that private banks attempt to attract customers through provision of better services and that the same attitude is reflected in their disclosure practices, that is, they use annual reports as a marketing tool.

Stefănescu (2012c) analysed the websites and annual reports of 46 banks listed on the London Stock Exchange for the year 2010. Here, Stefănescu (2012c) studied the relationship between corporate governance disclosures and



ownership concentration through correlation analysis. The results of the research revealed that corporate governance disclosures are negatively related to ownership concentration.

Existing literature also argues that there is a negative relationship between family control and corporate governance disclosure (Arcot and Bruno, 2012; Darmadi and Sodikin, 2013). Considering this strong evidence from the prior literature recognising the impact of ownership structure on corporate governance disclosure, annual reports of family owned and controlled listed companies are studied in this research project. Therefore, ownership structure will not be a determinant of variation in the level of disclosure across the companies studied.

#### ***Voluntary and Mandatory Disclosure Comparison***

Samaha et al. (2012) found that the level of mandatory corporate governance disclosures in the financial statements and websites of 100 companies on the Egyptian Stock Exchange was higher than the level of voluntary disclosure provided therein. Muhamad et al. (2009) studied the voluntary as well as mandatory corporate governance disclosure practices of listed companies in Malaysia. They found that the level of mandatory disclosure was good, being that most of the companies were meeting regulatory requirements. They also found a high level of voluntary corporate governance disclosure in the annual reports of the companies.

#### ***Multiple Listing and Corporate Governance Disclosure***

A number of researchers have studied the relationship between firms listing on multiple stock exchanges and corporate governance disclosure and found a positive relationship. Ben-Amar and Boujenoui (2006) found a positive

relationship between the multiple listing of firms and the level of corporate governance disclosure. Collett and Hrasky (2005) analysed the annual reports of 29 companies and found that the companies listed in multiple stock exchanges provided better corporate governance disclosure than the ones that were listed only in the Australian Stock Exchange. Andersson and Daoud (2005) also found that there was a positive relationship between the multiple listing of the company and the level of corporate governance disclosure.

Desoky and Mousa (2012) studied the corporate governance disclosure practices of 100 companies listed on the Egyptian Stock Exchange. Here they used the technique of multivariate analysis to find that corporate governance disclosure was positively associated with the foreign listing of the company. They argued that the companies listed on multiple stock exchanges have to comply with the disclosure requirements of all the stock exchanges where they are listed and that, therefore, they provide higher corporate governance disclosure. However, this study analysed the data of the annual reports and web pages of only 100 listed companies in Egypt. Therefore, the results of this study might not be widely generalisable.

This literature review shows that various factors have been identified as having an influence on the level of corporate governance disclosure by listed companies. It may be noted that most of the research conducted so far is quantitative in nature and provides contradictory results. It might thus be argued that there is a need for more qualitative research in the field, being that qualitative research generates rich knowledge providing interpretation and explanation of observed phenomenon. Furthermore, the choice of a qualitative

methodology might enlarge a seemingly small body of qualitative corporate governance research within the emerging markets (McNulty et al., 2013)

This research fills the afore-mentioned gaps in the existing literature through qualitative analysis of research data. In addition, the use of qualitative methods also proved suitable in generating a deeper understanding so as to answer research questions in the most appropriate manner (Bluhm et al., 2011).

#### ***Corporate Governance and Disclosure – Research in Pakistan***

Several researchers have explored corporate practices regarding corporate governance and disclosure in Pakistan's context. Rais and Saeed (2004) carried out an assessment of corporate governance practices of listed companies in Pakistan. They conducted a survey of 29 listed companies, analysed 40 corporate annual reports and conducted interviews with various stakeholders and found that most of the companies had started implementing the provisions of the Code of Corporate Governance (2002).

Rais and Saeed (2004) found that the companies had started restructuring their boards, holding annual general meetings and providing more transparent disclosures. However, Rais and Saeed (2004) argued that companies had been facing the problem of a lack of awareness and training for compliance with corporate governance requirements. Rais and Saeed (2004) further argued that although the Code of Corporate Governance had been implemented in form, it did not meet the underlying intention for implementation of corporate governance regulations. Therefore, companies provide minimum information to comply with the requirements of the regulation.

The World Bank (2005) carried out an assessment of corporate governance framework in Pakistan. The World Bank (2005) argued that, in most of the

companies in Pakistan, family members dominate shareholder meetings and directors are not accountable to minority shareholders. It was also found that family owned companies are typically managed by the family owners themselves and that there has been no distinct separation between ownership and control. Typically, the boards have insufficient awareness about the fiduciary duties and are dominated by majority shareholders.

The World Bank (2005) also found that since controlling families appoint their representatives on the board, the majority of the boards are not independent. It was found that the members of the board are not being paid adequate remuneration and, as a result, it is not attractive for qualified individuals to accept a directorship in these companies. The World Bank (2005) further claimed that the companies in question have realised the need for better corporate governance and that many corporate organisations are arranging training and seminars for the members of the board. In addition, the Pakistan Institute of Corporate Governance (PICG) has been established with an aim of providing corporate governance training to the directors of the companies.

The International Finance Corporation (2007) conducted a survey to investigate the practices of the companies in Pakistan's corporate sector. The International Finance Corporation (2007) found that although 98% of the respondents claimed that they comply with the provisions of the Code of Corporate Governance (2002), 89% of the respondents complied with the requirements of the code only because it was mandatory to comply. The respondents did not acknowledge any practical significance of following the Code of Corporate Governance, while 82% of the respondents considered that

compliance with regulation was the most important benefit of following the Code (as non-compliance might result in imposition of penalties).

In addition, the International Finance Corporation (2007) found that the companies adopted only those corporate governance mechanisms to which they needed to adhere by law. The respondents to the survey did not show any interest in practising voluntary corporate governance. The results of the survey also indicated that 31% of the respondents considered there was no barrier to adoption of corporate governance being that it was mandatory and was meant to be followed at all costs.

Furthermore, 69 per cent of the respondents considered lack of training and lack of awareness to be obstacles in practicing corporate governance. These findings support the findings of Rais and Saeed (2004) who had argued that the lack of training was a major obstacle in the implementation of the Code of Corporate Governance (2002). Furthermore, 21 per cent of the respondents considered dissemination of sensitive proprietary information to be an important barrier, while 14 per cent of the respondents considered that lack of significance was a major reason for their lack of interest in adopting corporate governance practices.

However, the survey conducted by International Finance Corporation (2007) was subject to certain limitations. Firstly, this survey used questionnaires, along with semi-structured interviews conducted with corporate directors, CEO's, CFO's and company secretaries. However, the survey did not include responses from regulatory bodies and statutory audit firms. Thus, this survey does not capture a regulatory perspective regarding corporate governance practices. Secondly, the survey included participants from listed as well as non-

listed companies. Being that non-listed companies are not legally required to comply with the mandatory provisions of the Code, there might be significant differences in perceptions and knowledge of corporate governance amongst research participants. Significant differences might also exist in the corporate governance practices of listed companies compared with non-listed companies, while this factor might have introduced significant bias into research findings. Thus, the survey findings do not represent the corporate governance practices of listed companies.

Thirdly, the survey relied on questionnaires and semi-structured interviews in its analysis of corporate governance practices. Thus, the results obtained from these sources of data might provide a good representation of respondents' perceptions about corporate governance practices. However, the findings might not provide evidence of the *actual* corporate governance practices of the companies. The current research has addressed these limitations through the conduct of semi-structured interviews with the representatives of listed companies, regulatory bodies and audit firms. Furthermore, this research goes beyond the analysis of respondents' perceptions regarding corporate governance practices and carries out an analysis of annual report data with the objective of gaining insights into the *actual* disclosure of listed companies. In addition, the survey was conducted in 2007, that is, only five years after the introduction of the Code of Corporate Governance in Pakistan. This research involves data collection and analysis in 2013; that is, almost 11 years after the introduction of the Code in the country. This research thus captures the most recent perceptions, knowledge and practices regarding corporate governance amongst the listed companies of Pakistan.

The United Nations Conference on Trade and Development (2009) analysed the mandatory corporate governance disclosure practices of the 30 largest companies listed on the Karachi Stock Exchange and found that these companies were disclosing only about half of the items in the disclosure index. The benchmark used for analysis was developed from International Standards of Accounting and Reporting. The United Nations Conference on Trade and Development (2009) thus pointed out that most of the companies were disclosing information implicitly through general statements regarding compliance and there was a need for increased explicit disclosures.

The United Nations Conference on Trade and Development (2009) found that all the 30 companies provided information on directors' remuneration; 28 companies provided information on composition and duration of the board; and 25 companies provided information on independence of the board. Only nine companies provided information on the qualifications and biography of board members, while only three companies disclosed information on professional development and training attended by the board. Information on the role of the board was provided by 13 companies while only nine companies disclosed information on the type and nature of duties performed by board members. In turn, Ali et al. (2011) analysed the annual reports of 83 companies listed in the KSE from 2005–2009. The results of regression analysis indicated a lack of transparency in corporate disclosures.

Pakistan Institute of Corporate Governance (2011) also conducted a survey on board practices in Pakistan and found that 75 percent of the respondents acknowledged that the board of directors plays an important role in strategic decision making of the companies. However, the respondents shared their

concerns regarding timeliness and accuracy of the disclosures provided. The respondents also stated that compliance with the Code of corporate governance should not be mandatory.

An analysis of literature on corporate governance disclosures in Pakistan reveals that companies are complying with mandatory requirements of the Code of Corporate Governance (2002). However, the literature also indicates that the companies prefer not to provide disclosure voluntarily. In addition, the information provided in the annual reports is not explicit, while researchers have also questioned the transparency of the information. The literature also argues that, although corporate governance has been implemented in form, the information provided does not meet the underlying intention for regulation implementation. Analysis of the literature also highlights that research on corporate governance disclosure in Pakistan is limited and that no study has yet attempted to understand how the institutional environment both affects and shapes the corporate governance disclosure practices of listed companies. As the prior literature has argued, corporate disclosure is one of the most important mechanisms of corporate governance framework (Treadway, 1987; Cadbury, 1992; Green and Graham, 2005; Lin et al., 2014). However, there is a lack of research exploring corporate governance disclosure practices in real life in terms of the context of its implementation. This research fills the gaps in literature through an in-depth empirical investigation of corporate governance disclosure practices of listed companies in Pakistan and has important policy implications (explained in detail in Chapter 7). Furthermore, no study in Pakistan has explored the impact of political influence on corporate governance disclosure. This study also fills this gap in the existing research.



The following section will now provide an overview of the research on the impact of political influence on corporate disclosure.

### **3.4 Political Influence and Corporate Disclosure**

Roe (2003) argues that a firm's political environment can have a deep impact on the development of national as well as firm-level corporate governance mechanisms in a country. Roe (2003) further argues that political context has the power to determine which type of ownership structure and corporate governance arrangements should persist and develop in an economy. These views are consistent with the argument presented by Shleifer and Vishny (1997, p. 738) who claim that corporate governance mechanisms can be altered by political process.

La Porta et al. (2000) argue that political differences between countries give rise to differences in laws. The processes of regulation formation, implementation and compliance involve constant human interaction and are influenced by politics. It might then be argued that since corporate governance systems and mechanisms (such as corporate disclosure) are also introduced by regulatory bodies through the introduction of formal regulations, then the development and enforcement of corporate governance might also be influenced by political power held by various stakeholders.

The impact of political influence on corporate disclosure has been recognised by the prior literature. Several empirical studies have found a negative relationship between political connectedness and the quality of accounting disclosure. Piotroski et al. (2015) investigated the impact of political connectedness on the disclosure of bad news in corporate communication within Chinese firms. They found that politically connected firms avoid

disclosure of bad news both prior to and after the occurrence of a political event in China. The purpose of restricting this flow of information is to save the politicians from the resulting embarrassment.

Fan et al. (2014) used a sample of 45 high profile corruption cases from 1996 to 2007 in China. Here they investigated the impact of political connectedness of the bureaucrats involved in these cases on the earnings' informativeness<sup>15</sup> of the connected firms. It was found that, owing to the difficulties in measurement of the value of political relationships, the ability of accounting earnings to track firms' economic performance diminishes. Thus, accounting information is more opaque in politically connected firms. They also argued that accounting information in developing countries is less informative than in developed countries.

Huang et al. (2014) also studied the influence of political connectedness on the quality of earnings information. They examined Chinese family listed companies from the Shenzhen Stock Exchange from 2003–2008 and found that politically connected firms provide poor quality information on their earnings.

In turn, Stuart and Wang (2014) studied the financial data from 467 Chinese firms, among which 102 firms were politically connected. The results of multivariate analysis indicated that politically connected firms manipulate their accounting information to a larger extent when compared with non-connected firms. Politically connected firms are less likely to be scrutinised by the regulators and this factor increases their likelihood of involvement in fraudulent reporting. In addition, in the case of the detection of a fraudulent

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<sup>15</sup>Zarowin (2006, p. 4) defined earnings informativeness as “the amount of information about future earnings and cash flows that is reflected in current period stock returns.”

behaviour, politically connected firms are not penalised efficiently or effectively which encourages poor reporting practices.

Chen et al. (2010) analysed the data from 114 politically connected firms from 1997–2001 from 17 countries. Statistical analysis of the data revealed that political connectedness makes it difficult to forecast a firm's earnings accurately. This in turn adversely affects the accuracy of the forecasts. The study also indicated that higher levels of corruption decrease the accuracy of earnings' forecasts by politically connected firms.

Studies on corporate disclosure and transparency have also found that political influence is negatively related to corporate transparency.<sup>16</sup> Bushman et al. (2004) studied the impact of legal structure and political economy on corporate transparency through an analysis of data extracted from the annual reports of 1,000 companies, listed across several countries around the world. They applied factor analysis to the quantitative data extracted from these annual reports and found that a firm's financial transparency was related to a country's political economy.

Through an analysis of data of firms from 32 countries, Riahi-Belkaoui (2004) found that the political connectedness of the firms results in greater earnings' opacity,<sup>17</sup> low accountability and inferior quality of accounting practices. Boubakri et al. (2008) also conducted a study of 245 politically connected firms across 27 developing and 14 developed countries. They found that politically connected firms influence appointments to boards of directors in newly privatised firms and that political connectedness is negatively related to

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<sup>16</sup> Bushman et al. (2004, p. 208) defined corporate transparency as the availability of firm specific information to company outsiders.

<sup>17</sup> Riahi-Belkaoui (2004) defined earnings' opacity as a measure reflecting the insufficiency of disclosed information regarding a firm's true but unobservable economic performance.

firm performance. Chaney et al. (2011) investigated the impact of political connectedness on the quality of accounting information and found that the quality of financial reporting in politically connected firms is significantly poorer than in non-connected firms.

However, some of the researchers investigating the relationship between political influence on corporate disclosure and transparency have found contradicting results. Batta et al. (2014) studied financial information from 29 listed Venezuelan companies from 2000 to 2008. They found that in economies experiencing high levels of expropriation risk, politically connected firms tend to disclose a better quality of accounting information.

Yen (2013) studied the impact of political connectedness on financial reporting in China-based companies listed on the Hong Kong Stock Exchange. Yen (2013) analysed annual reports and corporate governance information of ten companies accused of fraudulent reporting and 99 companies not accused of fraudulent reporting from 2006 to 2008. The results of regression analysis indicated that political connectedness does not increase the likelihood of fraudulent financial reporting. However, this research only studied a small sample of ten politically connected firms, while the number of non-connected firms was 99. The results of the study might be influenced by this factor and their reliability might therefore be questioned.

Similarly, Khemakhem and Dicko (2013) studied the corporate governance compliance practices of 300 Toronto Stock Exchange firms for the year 2010. The analysis of directors' circulars and annual notices revealed that politically connected firms comply with regulatory requirements as non-compliance

results in an increase in the risk of penalties, an increase in financial costs and accusations of favouritism.

These results contradict with the findings of Stuart and Wang (2014), who argued that politically connected firms are under a lower level of scrutiny from regulators. However, it is important to note that Khemakhem and Dicko (2013) conducted their study on companies listed on Toronto Stock Exchange, while Stuart and Wang's (2014) research was carried out on the technology compaines operating in China. There might be significant variations in the nature of regulations, the expectations relating to regulatory compliance and other institutional factors prevailing in these two different research settings. These contradictions in the existing quantitative corporate governance research have highlighted the need for more in-depth research. This research will attempt to understand these phenomena in the context of Pakistan by conducting an in-depth analysis.

Sari and Anugerah (2011) studied the impact of political influence on corporate transparency using government ownership as a proxy for political influence and found a positive relationship between the two. Sari and Anugerah (2011) also studied this relationship using the existence of politicians on the board of directors as another proxy for political influence and found no significant relationship between them.

Various researchers have explained the different reasons for poor disclosure in the corporate communication of politically connected firms. Bushman et al. (2004) argue that politicians might restrict the flow of information to the public with the aim of hiding the favours they extend to their acquaintances through nepotism, bribery and political support. Tinker and Neimark (1987) argue that

accounting information and disclosure are not merely ways of transmitting objective accounting facts, but constitute a socially constructed reality and are used as a tool for dissemination of wealth and power amongst social actors.

Green and Graham (2005) argue in turn that the board of directors uses corporate disclosures as a tool for management of perceptions regarding a company situation. Watts and Zimmerman (1986) claim that large companies are more politically visible, and in order to limit political interference, they disclose more information. Riahi-Belkaoui (2004) assert that politically powerful leaders use their power to provide benefits to their friends, family members and connected firms through distortion of incentives, rent seeking and corruption. Although these connections provide the benefits of easier access to bank finance, lower taxation and market power, these firms do not perform better than their peers in the long run. Consequently, directors perform more opportunistically through shirking and rent seeking. In order to hide the poor performance of the firm, they manipulate financial statements, thus increasing earnings opacity and decreasing disclosure quality (Riahi-Belkaoui, 2004).

An analysis of the existing literature highlights a few important gaps. First, most of this research focuses on the analysis of the influence of political connectedness on the quality of financial information disclosure. None of these studies focuses on determining the relationship between political connectedness and corporate governance disclosure. In addition, the existing literature has predominantly used quantitative methods for investigation. In order to deal with the problem of contradictory evidence, many researchers have emphasised the need to understand corporate governance through in-

depth research, conducted in the real life context of organisations (Lan and Heracleous, 2010; McNulty et al., 2013). Furthermore, in spite of the fact that Pakistan is a country with a high level of political networking and corruption, no study has investigated the influence of politics on corporate disclosures. This research project fills these gaps in the literature through an in-depth empirical investigation carried out in the context of Pakistan.

The following section explains the various theoretical lenses utilised for the purpose of developing an understanding of the phenomena under research.

### **3.5 Corporate Governance and its Disclosure – Theoretical Underpinnings**

The following section provides a review of the relevant literature recognising the impact of political influence on corporate governance disclosure.

#### **3.5.1 Agency Theory**

Agency theory provides the most dominant theoretical explanation in corporate governance literature (Daily et al., 2003). An agency theory perspective views corporate governance as a mechanism devised for resolving agency problems arising from the separation of ownership and control in corporate organisations (Berle and Means, 1932; Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983). Agency theory assumes that the principal (owner) hires the agent (manager) to seek benefit from the agent's expertise, skills and knowledge to maximise returns on his/her investment.

However, in order to maximise the returns on investment, the principal has to delegate certain decision-making rights to the agent. The agent thus serves the principal and is entitled to remuneration for these services. However, agency theory assumes that human beings are opportunistic in nature and that

managers (agents) will not always work in the best interest of the principal (owner), maximising their personal gains over organisational interests.

As managers are opportunistic in nature, they are expected to maximise their self-interest, the principal (owner) will use two basic instruments to control managerial opportunism. First, she/he will offer the manager incentives in the form of suitable remuneration packages. Second, she/he will have to incur costs in monitoring the manager's possible misappropriation. Moreover, the owner will pay incentives to the manager, in order to ensure that he/she keeps on working for the enhancement of the firm's wealth and resources, instead of taking any actions that are harmful to the business. All these costs, collectively, are referred to as agency costs. Agency theory is therefore grounded in the basic assumption of neo-classical economic theory that human beings make rational choices after making a careful assessment of risk and so work for the maximisation of their self-interest (Jensen and Meckling, 1976; Aguilera and Jackson, 2003).

The traditional agency perspective views a business organisation as a 'nexus of contracts' between various participants within and outside of the organisation. Fligstein and Choo (2005) state that these contracts delegate specific rights and obligations to the agent and also indicate the compensation to which the agent is entitled, after fulfilling his/her obligations under the contractual terms. The contract between the principal and agent also specifies the mechanisms available to the principal for monitoring the performance of the agent. However, owing to the limited ability of human beings to draft complete contracts, it is not possible to incorporate all the possible disputes and contingencies that might arise during the span of the contract (Hart, 1995).



An agency theory perspective views corporate governance as a set of cost effective arrangements aimed at monitoring the activities of managers and aligning the interests of owners and managers, in order to minimise the costs of opportunistic managerial behaviour that owners may suffer. This is achieved through remuneration incentives, the provision of legal protection and through devising the means for formulating the most efficient and cost effective contract (Eisenhardt, 1989; Daily et al., 2003; Feldman and Montgomery, 2015).

#### *Agency Theory in Developing Countries*

The existing literature has investigated the nature of the agency problem in capital markets with high levels of ownership concentration. It is argued that the traditional model of agency (as explained above) is appropriate for well-developed and efficient capital markets and cannot be suitably applied to markets in developing countries characterised by concentrated ownership (Young et al., 2008). Young et al. (2008) argue that shareholders are widely dispersed in developed countries, resulting in a separation of ownership and control in corporate organisations. The classical model of agency addresses agency problems arising from separation of ownership and control between principal and agent (Jensen and Meckling, 1976).

In contrast, however, the agency problem is distinct in developing countries. These countries are characterised by high levels of ownership concentration and strong family control (Gilson, 2007). There is a lack of strong external governance mechanisms. The conflict of interest prevails between majority/controlling shareholders and minority shareholders, often termed as a principal-principal conflict (Filatotchev et al., 2005; Young et al., 2008). Lau

(2010) argues that, in family owned and controlled listed companies, decision making and management roles are held by the same individuals; that is, the controlling members.

Fan and Wong (2002) state that in markets with high levels of ownership concentration, owing to weak legal institutions and external corporate governance mechanisms, it becomes easier for controlling shareholders to expropriate the rights of minority shareholders. These controlling shareholders also control the reporting and disclosure practices of companies. Being that these majority shareholders are engaged in rent-seeking opportunistic behaviours at the cost of minority shareholders, they restrict the flow of information while providing disclosures.

Fan and Wong (2002) further elaborate another reason for poor disclosure in these markets. The controlling shareholders restrict the flow of such information that they consider to be of a proprietary or sensitive nature. Young et al. (2008) explain that the flow of sensitive information is especially an issue in developing economies. Owing to weakness in institutional environment and lack of legal protection, there is a lack of trust between parties. As the principal-managers in these economies do not trust outsiders, they show reluctance to share information. Being that Pakistan is also a developing country with a highly concentrated capital market (as explained in Chapter 2), the nature of agency conflict and its influence on corporate governance disclosure is worth exploring in Pakistan's capital market.

*Agency Theory and the Study of Political Influence on Corporate Governance Disclosure*

An agency theory perspective provides a good explanation for the existence of the political power and influence in companies. Wong (2004) argued that agency conflict in politically connected firms is more severe than in non-connected firms. He argued that, in non-connected firms, conflict only exists between managers and shareholders. However, in politically connected firms the interests of politically connected members of the board also diverge from the interests of shareholders. Politicians have vested political interests. They have the power to influence managerial decision-making, being that they may use subsidies and bribes to influence management in the firm. Thus, in politically connected firms, two forms of agency conflict exist; first, between shareholders and politically connected members of the board and secondly, between managers and shareholders. Thus, the involvement of politicians in the firms gives rise to a double agency problem.

La Porta et al. (1998) argued for the existence of a negative relationship between investor protection, the rule of law and ownership concentration. It is argued here that, owing to poor law enforcement and weak investor protection, ownership is concentrated in Pakistan (Mumtaz, 2005; Iqbal, 2008; Mirza and Azfa, 2010; Nawazish and Sara, 2012). Concentrated ownership structures result in a concentration of power in the hands of dominant shareholders (Bebchuk, 1999), who then use controlling rights to maximise their own private benefits.

Nam et al. (2001) argue that the appointments of members of the board of directors in highly concentrated firms are made under direct influence from the

controlling shareholders. In emerging economies, firms having concentrated ownership structures demonstrate a high level of political connectedness (Chen, 2004; Morck et al., 2005). Politically connected powerful shareholders use their power to influence managers to engage in activities that might be harmful for minority shareholders, so serving their political interests (Charreaux and Desbrieres, 2001; Roe, 2003). Correia (2009) argues that, owing to poor law enforcement mechanisms being in place, politically connected firms exercise political power and display high levels of misreporting.

Fan and Wong (2002) and Morck et al. (2005) explain the political nature of agency conflict in the markets displaying concentrated ownership structures. Fan and Wong (2002) argue that owing to the considerations related to political lobbying and information disclosure to competitors, keeping proprietary information confidential is one of the key interests of the controlling shareholder. Shleifer and Vishny (1994) argue in turn that politicians' involvement in company affairs (such as being members of the board) results in their bargaining with managers, whereby they offer bribes to the managers in pursuit of their political interests. Thus despite being the agents of the shareholders, politically connected members of the board work to fulfil their personal political interests. Consequently, the presence of politically connected members on boards ultimately leads to a lower level of disclosures and transparency.

Several studies have explored the impact of political connectedness on the quality of disclosure and transparency in firms through conducting a cross-country analysis (Bushman et al., 2004; Riahi-Belkaoui, 2004; Chaney et al.,

2011). A few studies have explored this relationship in developing countries, such as that of Liu and Lu (2007) in China and Sari and Anugerah (2011) in Indonesia. However, all of these studies have used quantitative method for analysis of data and there remains a scarcity of qualitative research in the field.; The existing literature does not ‘explore, describe and compare’ corporate governance phenomenon in the real life context of these countries (McNulty et al., 2013, p.184). Therefore, the existing quantitative corporate governance and disclosure literature is institutionally insensitive and fails to generate a deep understanding of contextual factors.

The agency theory perspective might then be utilised for the development of the following propositions relevant to this research.

- Considering the high levels of ownership concentration<sup>18</sup> in the capital market of Pakistan, the existence of agency conflict between minority and politically powerful majority shareholders is expected. Politically connected majority shareholders have strong control over company management and work to foster their political interests.
- Politically connected firms face a double agency problem. Politically powerful members of the board use their power to provide benefits to their friends, family members and connected firms through the distortion of incentives, rent seeking and corruption. In order to hide these rent-seeking activities, they are expected to constrain flows of information to minority shareholders by influencing management.

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<sup>18</sup> Javed and Iqbal (2010) defined ownership concentration as the percentage of ownership in a firm by large investors. They argued that ownership is highly concentrated in Pakistan’s capital market being that only a small number of shareholders own a majority of shares in listed companies.

- Politically connected members of the board may want to present accounting information and performance in the annual reports in such a way as suits their personal and political interests, which ultimately results in a poor level of corporate governance disclosure.

Since there is a lack of qualitative research in this field, this research project will investigate these propositions through a context-based enquiry into the institutional environment of corporate organisations of Pakistan. The use of qualitative research will assist in creating a deeper understanding about the institutional complexities in the capital market of Pakistan and help in finding explanations for the corporate governance disclosure behaviour of the companies.

Several researchers have criticised the assumptions of traditional agency theory (as explained above) for being too rigid and insensitive to institutional factors. Some of the researchers have called for expansion in this traditional approach and have also proposed generalised/institutionally sensitive models of agency theory. The following section provides an account of this criticism, along with an explanation of various generalised/institutionally sensitive models proposed by various researchers.

#### *Agency Theory: A Critique*

Although prior literature has widely utilised the traditional agency theory perspective (as explained above) for explaining the relationship between corporate governance mechanisms and economic outcomes, agency theory has also been widely criticised on the grounds of not providing convincing evidence in support thereof (Roberts et al., 2005; Brennan, 2006; Heracleous, 2008). An increasing number of researchers now emphasise the investigation

of corporate governance in the context of its application; that is, in relation to the institutional environment where corporate governance is introduced and implemented (Heracleous, 2008; Heracleous and Lan, 2012).

Fligstein and Choo (2005) point out the failure of agency theory to account for the differences in effective corporate governance systems in different economies across the world. They argue that the agency theory perspective emphasises on the role of corporate governance institutions in meeting the functional requirement of the owners of capital. However, this perspective completely ignores the role of political and historical processes in formation of the institutions in these contexts.

Wiseman et al. (2012) also criticised traditional agency theory for its over-emphasis on the design of economically efficient contracts, while completely ignoring the role of social norms in controlling agency costs. Wiseman et al. (2012) argue that this approach has resulted in an over-emphasis on testing agency theory assumptions through a calculative analysis of transactions. In order to deal with this inability of agency theory to recognise institutional factors, Wiseman et al. (2012) stress the need to move beyond the traditional agency perspective. Instead, they propose a socialised approach to the agency theory.

Wiseman et al. (2012) argue that the rigid assumption of self-interest was introduced by neo-classical economists for the purpose of attaining computational efficiency. This assumption restricts the application of agency theory in the context of varying institutional settings. They instead suggest the replacement of the assumption of self-interest in the traditional agency model with the broader assumption of conflict of interest between the principal and

agent, where the conflict does not necessarily arise because of wealth maximisation.

On the other hand, Hendry (2005, p. 55) proposes a generalised version of agency theory for gaining deep insights into the conduct of a board of directors in a real life situation. He also recognises the limitations of the traditional agency perspective (based on the rigid assumptions of agent's self-interest and opportunism for maximisation of wealth), so proposing an expansion to the theory. Hendry (2005, p. 58) hence proposes that the assumptions of opportunism and competence made about the agents should be replaced with the assumptions of 'honest endeavour' and 'bounded rationality'. In this generalised version the agent is expected to work honestly and yet he may be incompetent; thus he might not always be able to act in the best interest of principal. Therefore, this generalised version of agency theory might also be testable through measurable economic models. Hendry (2005, p. 58) so proposes that, by using this model of agency theory, researchers can also benefit from the assumptions of traditional agency theory. Nonetheless, the scope of the theory broadens according to the availability and use of alternative assumptions.

Heracleous and Lan (2012) also suggest the development of an institutionally sensitive model of the agency perspective. Heracleous and Lan (2012) propose a legal perspective of agency theory. They criticise this assumption of the traditional agency model where shareholders are the principals in corporate organisations. Instead, Heracleous and Lan (2012) argue that the corporation is a separate legal entity and should thus be considered as a principal. Therefore, the aim of the board should be to work to maximise the corporation's interest



as a whole instead of protecting only shareholders' interest. Heracleous and Lan (2012) further argue that directors should not be considered as self-interested individuals, but rather as fiduciaries. In addition, the directors act as mediators between various stakeholders in corporate organisations. It is then to be argued that the agents are trustworthy and intend to serve the corporation in creating collective benefit for all organisational stakeholders.

Research based on the agency theory perspective is predominantly quantitative in nature. This emphasis on quantitative testing of agency theory assumptions has resulted in the development of a vast quantitative literature in the field. However, the existing literature completely ignores the factor that economic transactions are socially embedded in phenomena where human perceptions and interaction play an important role in shaping economic contracts and determining economic outcomes.

Many researchers stress the application of the agency theory perspective in a real life context. Eisenhardt (1989) stresses the utilisation of an agency theory perspective in conducting an in-depth investigation of agency problems. Eisenhardt (1989) argues that agency theory might be applied for exploring real life phenomena in a similar fashion to which institutional and resource dependence theories are applied. The application of agency theory becomes most relevant in the situations where there are goal conflicts, information asymmetry and opportunism. Eisenhardt (1989, p. 71) emphasises utilisation of the agency theory perspective “with complementary theories.” Even though agency theory provides only a partial view of the world, this shortcoming of ignoring real life complexities does not undermine its power and usefulness in explaining conflict within organisations.

It might be inferred that the current quantitative research on the agency conflict in corporate governance literature has attempted to explain the actions of agents (such as poor disclosure) on the basis of the rigid agency theory assumptions. However, these assumptions may not be true. It might be inferred that, in Pakistan's context, politicians might be acting benevolently instead of being opportunistic. They might be working in best interests of their principals; therefore the model developed on the claims of opportunism and self-interest may not provide any useful explanation of their actual behaviour (Hampsher-Monk and Hindmoor, 2010). Their behaviour might, in fact, be the result of various other overlooked institutional factors. However, these aspects need to be explored further and it is an aim of this research project to investigate these aspects through an in-depth analysis of corporate governance disclosure.

This investigation is informed by a combination of the institutional and agency theory perspectives. The decision to use both of these theoretical perspectives together is consistent with the suggestions of prior literature which stresses the need to explore complex social phenomena using multiple theoretical perspectives. For example Eisenhardt (1989, p.71) recommends that researchers should "use agency theory with complementary theories." Cohen argued that whereas agency theory provides a useful lens to view the world partially, it is inadequate to capturing fully the complexity in phenomena. Cohen et al. (2008) argue that the use of multiple theoretical perspectives can help in dealing with this shortcoming of agency theory. Thus, the limited ability of agency theory to explain real life situations might well be dealt with through the use of additional perspectives presenting the possibility of capturing the complexity inherent in real life situations.

Many researchers have combined institutional and economic perspectives to understand complex organisational phenomena. Carpenter and Feroz (2001) argue that the combination of an institutional perspective with the economic perspective of self-interest enabled them to understand how environmental factors determine the choice of accounting regulations in public sector organisations in the USA. Dacin (1997) argues that it is not only institutional forces that affect organisations over time, but ecological and economic factors also play an equally important role and should be addressed carefully in organisational studies.

Meanwhile, Cohen et al. (2010) used institutional and agency theory approaches to explore auditors' perceptions regarding corporate governance structure under the Sarbanes-Oxley reforms. They found that both agency and institutional perspectives provide explanations regarding the studied phenomenon. The findings of this interview based in-depth study by Cohen et al. (2010) supported the explanations provided by the agency theory perspective. Kalbers and Fogarty (1998) also utilised both agency and institutional perspectives for the study of the effectiveness of the audit function in organisations. They argue that neither theory alone is capable of providing a complete view, so emphasising the need for a fusion of theories to study the effectiveness of corporate governance mechanisms.

Nicholson and Kiel (2007) examined the link between the board of directors and firm performance using agency, stewardship and resource dependence theories. A case study approach was followed and the methods of data collection included in-depth interviews and analysis of organisational documents. Nicholson and Kiel (2007) stress the need to examine

organisational processes in a real life context, rather than simple co-relational studies linking various variables quantitatively.

Therefore, this research project addresses the afore-mentioned gaps in the existing literature through the utilisation of rational choice institutionalism and agency perspective in the development of careful and logical propositions. The empirical research was carried out using an institutional framework, whereby the established propositions were assumed to be subject to variations specific to a unique context. The aim has been to take into account the complex nature of real world phenomena and to seek an explanation of the phenomenon under research. The assumptions of one theoretical lens might be used to complement the weakness of the other theory, rather than highlighting the theoretical contradictions. The adoption of a critical realist stance<sup>19</sup> also indicates the acceptance of the existence of economic and institutional structures (such as self-interest, rationality, etc.), while recognising the importance of the perceptions of social actors.

### 3.5.2 Institutional Theory

Institutional theory provides a perspective for understanding any rich and complex phenomenon in real life situations. It explicates the powerful role of formal and informal constraints in shaping and facilitating human interaction. This theory suggests that institutions might emerge as *exogenous constraints* - that is, the rules of the game arising from external sources such as government - or that they might arise as *endogenous constraints* arising within the organisation, in the form of institutional arrangements such as organisational policies (Shepsle, 2006). Zucker (1987) calls these constraints *normative*

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<sup>19</sup> A detailed discussion on critical realism can be found in Chapter 4, Section 4.1.

*pressures*, claiming that such constraints pressurise organisations to follow such procedures and regulations as they might help them attain legitimacy<sup>20</sup> in the institutional environment (Scott, 1987; Suchman, 1995).

Institutional theory offers deep insights into the social construction of the institutional environment. Scott (2005) argues that institutional forces are most powerful in socially constructed cultural and network systems, and can be examined most readily through an analysis of such systems. Institutional theory recognises an organisation to be an ‘open system’<sup>21</sup> taking into account the role played by the organisational environment in influencing organisational practices, such as the level of corporate governance disclosure. Institutional theorists argue that, in addition to the production and information functions, organisational context is also influenced by social and cultural forces. These forces play an important role in shaping organisational practices (Scott, 1995; Bjorck, 2004). Therefore, organisational context is not only a simple construction of the interactions between various institutional actors; rather, it emerges out of complex historical and social phenomena (Meyer, 2008).

Furthermore, institutional theory suggests that the institutional environment influences organisational behaviour through the establishment of informal norms and beliefs, along with formal rules and regulations. Organisations follow these norms and regulations for the purpose of obtaining legitimacy and support (Scott and Meyer, 1983).

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<sup>20</sup>Suchman (1995, p. 574) defined legitimacy as a socially constructed assumption about the actions of an entity insofar as they are desirable, appropriate or proper and are in alignment with social beliefs, values and norms.

<sup>21</sup>Zsidi et al. (2005) explained that in an open system, organisations interact with their internal and external environments. These environments exert an influence on organisations, while they are themselves also capable of influencing these environments.

Institutional theory recognises that institutional environments are interconnected and organisations might be subject to “conflicting institutional demands and constraints” (Oliver, 1991, p. 147). These demands and constraints arise as a result of individual behaviour being affected by the institutional environment while, at the same time, exerting influence on the institutional environment. Powell and Colyvas (2008) argue that institutional theory recognises the important role of institutions in shaping human interaction. However, Powell and Colyvas (2008) emphasise the need for understanding the role played by individuals in institutional construction. An effort must therefore be made to understand how the interests and actions of the individuals influence the rich institutional context. It is therefore argued that institutional theory offers rich insights into the social construction of various actors<sup>22</sup> in the institutional environment.

Scott (1995, pp. xiii-xiv) argues that institutional analysis can be useful for acquiring answers to the following questions.

- Do rational interests and conscious choices of individuals (for example, politically connected members of the board) play any role in the construction of the collective behaviour (of the board) in an organisation?
- Why does the behaviour of organisational participants (for example politically motivated behaviour of connected members of the board) depart from the formal rules (corporate governance disclosure

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<sup>22</sup> An institutional actor might be an individual person, a government, a state or an organisation created by persons or state. An institutional environment emerges as a result of the interaction between these actors. (Powell and Colyvas, 2008, p. 789).

regulations) and stated goals of the organisation (for example, a company's stated objective of transparency)?

- Are the interests of the organisational participants socially constructed or are they guided by human nature (for example, assumptions about human self-interest and opportunism)? This implies the need to explore whether human beings are intrinsically self-interested and opportunistic or whether their behaviour is shaped under the influence of social perceptions and interpretations.

This research will therefore provide insights into a similar phenomenon focusing on the behaviour of individual participants (politicians), who are assumed to be rational individuals holding personal interests and preferences. It will investigate how the political connectedness of the members of the board of directors influences the level of disclosures in organisations. It will explore how disclosure practices vary in listed companies, with varying levels of political connectedness, within their boards of directors.

Institutional theory has undergone a process of transmission and development over time (Granovetter, 1992). These developments have resulted in the emergence of various theoretical approaches within the institutional approach. The following section discusses a distinct approach to institutionalism called 'rational choice institutionalism', as it provides useful insights to the phenomena under research.

### ***Rational Choice Institutionalism***

Rational choice institutionalism has its roots in rational choice theory. Rational choice theory assumes that the collective behaviour of the society is an aggregate of individual behaviour and that individuals act rationally to

maximise personal interest. Rational choice theory did not take into account the impact of institutions and institutional arrangements and their interaction with individuals in conducting social and economic analysis. It resulted in a failure on the part of rational choice theory to explain why different individuals had varying preferences and how they came into being.

Rational choice institutionalism overcame this limitation through the study of individual behaviour in the context of its institutional environment and arrangements. Rational choice institutionalism hence bridges the gap between the study of individual behaviour and institutional context, arguing that individual behaviour should be studied with reference to the institutional settings in which that behaviour is exhibited (Rakner, 1996; Hampsher-Monk and Hindmoor, 2010). On the one hand, rational choice institutionalism shares the assumptions of self-interest, utility and wealth maximisation with the agency perspective; while on the other hand, it recognises the rich and complex role of institutional forces in shaping human interaction.

Rational choice theory represents an important theory in the study of political science and economics. It is argued that individuals are rational beings and utility maximisation is and will always remain their primary motivation. An individual's preferences and strategic calculations are the basic units of analysis in rational choice institutionalism. Institutions and institutional outcomes are the results of individual behaviour and interaction (Wu, 2009). However, rational choice institutionalists argue that although institutions serve as intervening variables and thus influence individual actor's behaviour, they are not its core determinants (Rakner, 1996). Rational choice theory recognises that the utility maximising behaviour of individuals gives rise to such



organisational problems as shirking and the institutions<sup>23</sup> (for example, corporate regulations) should be designed in such a way, so as to direct the self-interested behaviour of individuals to achieve desirable collective outcomes (such as better corporate governance disclosure) (Peters, 2005).

Hall and Taylor (1996) explain the four basic assumptions of rational choice institutionalism. These assumptions are explained as follows, along with an elaboration of how they explain the phenomena under research.

1. Institutional actors (for example, politicians) possess sets of utility maximising preferences (for example, a display of politically motivated behaviour in setting company's strategic decision making and political influence on management for execution of politically motivated activities) and they behave in a strategic manner for the attainment of those preferences.
2. In pursuit of their own preferences, the individual actors are likely to opt for such outcomes that might be collectively unfavourable (for example, politically connected board members might expropriate shareholder rights and conceal that behaviour through poor corporate governance disclosure leading to a loss for shareholders).
3. Each actor's behaviour is driven by his/her strategic calculations regarding another actor's behaviour (politically connected members of the board might become involved in expropriation of shareholder rights as they are aware of weak legal protection available to those weak shareholders). Institutions (such as weak regulatory institutions) help institutional actors to make calculations according to the provision of

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<sup>23</sup>'Institutions are humanly devised constraints that shape human interaction' (North, 1990, p. 3). In this sense, corporate governance and disclosure regulations represent regulatory institutions.

information regarding other actors' behaviour and enforcement mechanisms and thus reduce uncertainty. This is how institutions affect human behaviour. (For example, strong legal institutions in the US and the UK protect dispersed shareholders and thus result in a good quality of corporate governance disclosures. However, in developing countries, weak legal institutions coupled with strong political corruption result in poor reporting quality and the expropriation of minority shareholders' rights/interests).

4. Rational choice institutionalism explains the development of institutions with an aim of value creation. The actors cooperate with each other for creating value and this process creates a distinct institution (Hall and Taylor, 1996).

Rational choice institutionalism aims at the development of such institutions that account for the expected human response to various institutional arrangements. It is believed that the creation of such institutions results in the maximisation of collective benefit. For example, the development of appropriate corporate and disclosure regulations might improve corporate governance disclosure, which will be collectively beneficial for all stakeholders, including minority shareholders. The theoretical perspective of rational choice institutionalism is thus utilised to develop following propositions.

- Politically connected members of the board have utility maximising preferences, and for meeting their self-interests they opt for such actions that are not favourable to (minority) shareholders.

- The behaviour of a politically connected board of directors is supported by their awareness of weak legal protection rights available to (minority) shareholders.
- In order to hide their politically motivated rent seeking activities, politically connected member of the board may constrain the dissemination of information to shareholders, leading towards poor quality of corporate governance disclosures.

This research will investigate these propositions empirically, focusing on how political connectedness of the members of the board influences shareholders' rights to disclosure regarding corporate governance.

#### ***Institutional Theory and the Study of Corporate Governance Disclosure***

There exists an emerging literature on the study of accounting practices from an institutional perspective. Accounting has been recognised as a socially constructed phenomenon and its standards, techniques and practices are influenced by institutional factors (Meyer, 1986; Hines, 1988). Hopwood and Miller (1994, p. 1) stresses that accounting is a socially constructed practice and various accounting techniques are used by organisations for gaining legitimacy in their institutional environment. The accounting techniques and practices are not only influenced by the institutional environment, but they also impose an influence on 'individuals, entities and processes' for achieving specific goals. Meyer and Rowan (1977) argue that accounting functions are supposed to be performed in a particular fashion in order to be seen as appropriate, legitimate and rational in the context of society.

It is argued that propositions drawn from rational choice institutionalism and agency theory will provide useful explanations regarding the impact of political

connectedness on the quality of corporate governance disclosures in Pakistan. This study will therefore make a significant contribution in literature as no study, to the best of the researcher's knowledge, has explored the dynamics of the influence of political influence on corporate governance disclosure in the context of Pakistan.

### **3.6 Identification of Research Gaps**

This review of the prior literature concerning the impact of political connectedness on corporate governance disclosures has highlighted the following gaps in the existing research.

1. There is a lack of research on corporate political connectedness in the South Asian region, especially Pakistan. To the best of the researcher's knowledge, this study is the first study on Pakistan to investigate this phenomenon.
2. Existing research has focused on determining how political connectedness influences the quality of financial reporting in the firms. No research, to the best of the researcher's knowledge, has so far investigated the influence of political connectedness on non-financial or corporate governance disclosure. This research intends to address this gap in the existing literature through an investigation of corporate governance disclosure practices.
3. Most of the existing research is quantitative in nature and there is a lack of qualitative research in the field. This study is then expected to contribute towards filling this gap through a detailed analysis of real life phenomena (McNulty et al., 2013). Qualitative research enables the researcher to seek explanations and draw comparisons in regard to

corporate governance phenomena. Therefore, qualitative research provides an opportunity to explore the context in which annual reports are prepared and decisions made in regard to corporate disclosures in Pakistan. Explanations have been sought regarding the influence of politically connected members of the board on the process of decision making regarding the level and nature of disclosure. The use of qualitative methodology has also allowed for a comparison between the disclosure practices of politically connected and non-connected listed companies.

This research project fills these gaps in the existing literature through the utilisation of the theoretical underpinnings of agency theory and rational choice institutionalism. Considering the institutional environment of Pakistan with its highly concentrated capital market coupled with high levels of political corruption, this research will be a valuable addition to the existing literature exploring corporate governance disclosure practices of listed companies along with the study of the impact of political connectedness on the corporate governance disclosures. Thus, in pursuit of the objectives of this research (see Chapter 1), an answer to the following research question will be sought:

‘How does political connectedness influence the disclosure of corporate governance information in annual reports of listed companies in Pakistan?’

To answer this main research question, the following research sub-questions will be addressed.

1. How do listed companies in Pakistan disclose corporate governance related information in annual reports?

2. How does political connectedness influence the disclosure of mandatory corporate governance information in the annual reports of listed companies in Pakistan?
3. How does political connectedness influence the disclosure of voluntary corporate governance information in the annual reports of listed companies in Pakistan?

### **3.7 Contributions of this Research – Addressing the Existing Gaps**

This research therefore makes the following contributions to knowledge.

1. This research has combined the theoretical underpinnings of agency theory and institutional theory. It is argued that both perspectives, if utilised together, jointly provide a better and more robust understanding of complex real life phenomena.
2. This research contributes to the limited body of empirical qualitative literature on corporate governance disclosure through an in-depth investigation of how political connectedness affects corporate governance disclosures.
3. This research involves a context based enquiry in the corporate settings of an under -researched developing country, namely Pakistan.

### **3.8 Conclusion**

This chapter has provided an account of the relevant literature related to the impact of political connectedness on corporate governance disclosure. A critical review has enabled the researcher to identify gaps in prior literature. It was observed that there is a lack of research exploring corporate governance disclosure practices of listed companies in Pakistan. It was also found that

there is a lack of research on the study of influence of political connectedness on the disclosure of corporate governance disclosure. The existing literature has mainly focused upon analysis of the quality of financial reporting. Thus, the disclosure of corporate governance information is specifically an under-researched area.

Furthermore, existing research has primarily utilised an agency theory perspective. This chapter has highlighted the need for and the usefulness of combining agency perspective with other complementary theories for explaining real life phenomena. An explanation has been provided regarding the use of agency theory, in combination with rational choice institutionalism, so serving as the theoretical foundation for this research. Research propositions have been developed for carrying out the research effectively. This chapter also highlighted that the existing research in the field is mainly quantitative and provides contradicting evidence. Thus this research addresses the calls for more qualitative research in the field of corporate governance disclosure. Chapter 4 provides an explanation and justification regarding philosophical and methodological underpinnings of this research.

## **Chapter 4 – Research Methodology, Design and Methods**

### **4.0 Introduction**

Chapter 2 of this thesis outlined the institutional background for this research in relation to Pakistan. Chapter 3 provided a detailed account of prior literature in the field of corporate governance disclosures and highlighted the theoretical underpinnings of this research. The review of the prior literature highlighted that most of the research in the field of corporate governance and disclosure has been quantitative and provides contradicting evidence. Chapter 3 also explained that many researchers have stressed the need for carrying out qualitative research in the field of corporate governance.

This chapter will outline the philosophy informing this research project. Explanations will be provided regarding research regarding the design of this research project. Furthermore, this chapter will elaborate upon the methods used for data collection and analysis.

Figure 4.1 shows how Chapter 4 is positioned in the thesis as a whole.



**Figure 4.1: Chapter 4 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan’s Institutional Context: Relevance to Other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
<b>Methodology Selection</b>	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical considerations</li> <li>– Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The Influence of Political Connectedness on Corporate Governance Disclosures</li> <li>– Conclusion</li> </ul>
<b>Findings and Conclusion</b>	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>

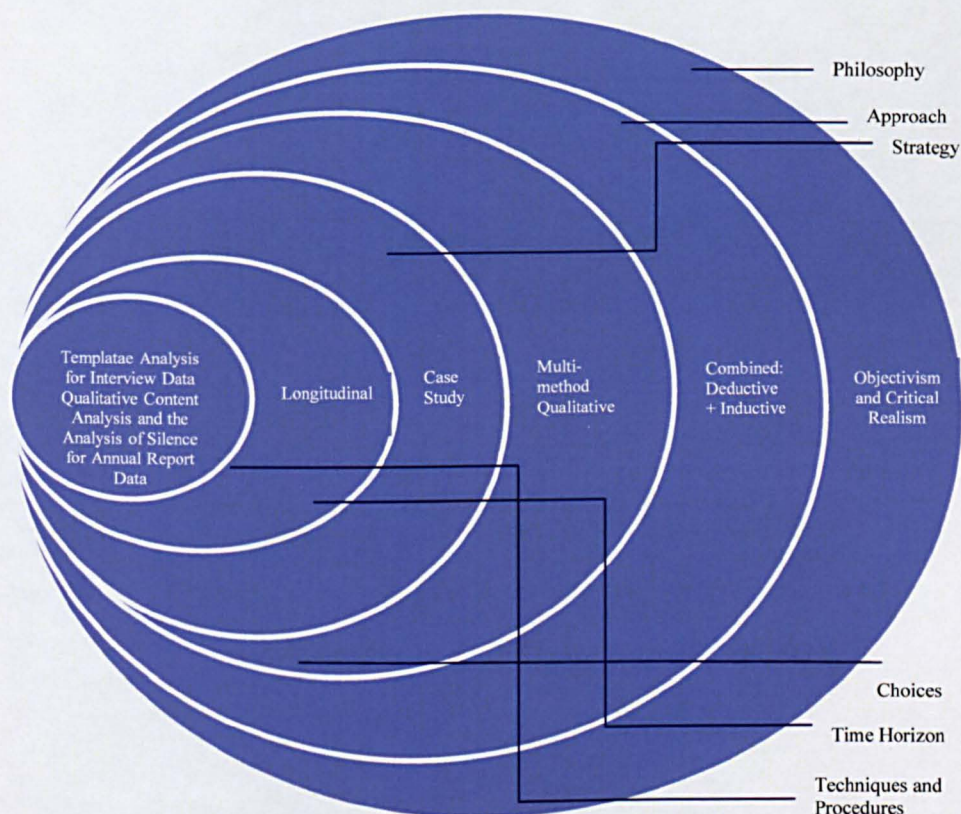
This chapter justifies the motivations for the selection of a qualitative research methodology informing the collection and analysis process of the research data. Section 4.1 will explain the philosophy, approach and design of the research project. Section 4.2 elaborates the methods used for collection of research data. Section 4.3 outlines the strategy for data analysis and explains various methods used for analysis of data. Since it was a qualitative research, section 4.4 explains the ethical considerations with regard to this project. Section 4.5 concludes this chapter.

### **4.1 Research Philosophy, Research Approach and Research Design**

This section will outline the philosophy, approach and design adopted for this research. For this purpose, the framework used by Saunders et al. (2012) has been used. The modified research onion in Figure 4.1 was originally provided by Saunders et al. (2012, p. 128). The modified research onion summarises the research philosophy and approach in the first two layers, while research design consists of research strategies, choices, time horizons and techniques is outlined in next four layers.



**Figure 4.2: Modified Research Onion**



Source: Saunders et al. (2012, p.128) and modified for this research.

The following sections will provide an explanation of the choices being made during the research process.

#### **4.1.1 Research Philosophy**

Research philosophy focuses on ‘what’ kind of knowledge is acquired and ‘how’ it is acquired (Saunders et al., 2012). Easterby-Smith et al. (2008) assert that a clear understanding of philosophical stance determines the type of evidence required for conducting research, the identification of an appropriate research design and the creation of such research designs that might be best suited for investigating a research problem. The main elements of research

philosophy, as explained by Saunders et al. (2012) are ontology and epistemology.

**Research ontology** refers to the researcher's view about how the social world operates. The two main ontological positions held by researchers are subjectivism and objectivism.

*Subjectivism* assumes that all social phenomena are the creation of human interaction. Thus social actors' perceptions and resulting actions shape organisational and managerial processes. This approach is closely linked to the philosophy of social constructionism. Easterby-Smith et al. (2008) explain that social constructionism assumes reality to be socially constructed. The aim of the research process under this ontological stance is to understand the meanings and interpretations that people allocate to a particular phenomenon.

*Objectivism* refers to the ontological position whereby social entities are assumed to exist independent of the perceptions of the social actors. Organisations and management processes are assumed to exist as objective realities. The organisations operate within formal structures and they are supposed to adhere to these structures (Saunders et al., 2012, p. 131).

This research draws upon the assumptions that social structures prevail in the management and business entities and thus constitute reality. From this perspective, this research project recognises objectivist ontology. However, this research also acknowledges the influence of social interaction, human perceptions and behaviour of individuals and groups on these social structures. Furthermore, it is recognised that these social structures also influence these human interventions. Therefore, this research also recognises the subjective

dimension of human action as an important constituent of knowledge and reality.

*Research epistemology* refers to the nature of the knowledge regarded as acceptable by the researcher. There are three main philosophical positions that a researcher might adopt in accepting research data as value laden. These philosophies include positivism, realism and interpretivism (Saunders et al., 2012).

*Positivism* refers to the philosophy under which the researcher adopts the position of a natural scientist and prefers to work with observable data that might lead towards the testing of one or more research hypotheses. Positivist researchers assume that there is a single objective reality that is observable and awaits discovery by the researcher. Positivist philosophy assumes that the purpose of enquiry is to generate testable theories that reveal universal laws and will provide the same results when replicated and repeated (Punch, 2013). Such studies are typically highly structured and exhibit greater elements of generalisability and replication.

Positivism is criticised by various researchers for ignoring the social embeddedness of knowledge (Hughes and Sharrock, 1997). Johnson and Onwuegbuzie (2004) argued that positivist research aims to provide a neutral and unbiased view of reality, although it is impossible for the researcher to carry out research without bias. Marshall (2006) also argued that it is not possible for positivist researchers to carry out value-free research as researchers have their own values, objectives and experiences. The social background of the researcher inevitably influences the research process either intentionally or unintentionally. A researcher has to make many subjective

decisions during the research process. For example, choices regarding research topic, research settings, sampling techniques and methods are most often affected by the researcher's social role and position.

Fineman and Opie (1987) argued that social phenomena are not 'objective' facts and positivist philosophy fails to incorporate alternative explanations of those factors that are not considered as objective. Although positivism leads towards determination of relationships between variables, it may fail to answer why and how those relationships exist. Thus it has a limited ability to answer how society can deal with real life problems.

*Interpretivism* assumes that the perceptions and beliefs of social actors influence their actions. Thus human behaviour is determined by their understanding of the social world around them (Saunders et al., 2012). Data are typically collected from fewer sources and the purpose is to generate an understanding and explanation of the researched phenomenon. The interpretivist methodology is criticised on account of its limited generalisability. However, the aim of interpretivist research activity is not to generalise findings to a wider population. A researcher can only provide an account of subjects' perceptions, while no predictions can be made utilising interpretivist epistemology.

*Realism* assumes that the reality exists independent of human perceptions and interpretations. Realists advocate the application of scientific approach for knowledge development in management sciences. Realism is further divided into two branches; that is, direct realism and critical realism. *Direct realism* assumes that our perceptions about the world are an accurate description of the actual reality that exists 'out there'.

*Critical realism*, however, recognises the role of human imagination and sensations. It is argued that the world is composed of actual reality, however our experience and senses affect our perceptions about that reality. We may, therefore, experience illusions and deceptive representations of the actual world. Critical realists argue that reality exists in two stages. In the first stage, the world exists with its actual structures. In the second stage, our mind develops an impression about the existence of the world under the influence of our sensations and experiences (Saunders et al., 2012).

### ***The Position Adopted***

This research follows critical realism. The position of critical realism was developed by Bhaskar (1978). It was considered to be the most suitable paradigm for this research as, on the one hand, it recognises the existence of such normative ‘structures, mechanisms and processes’ as institutions, utility functions, opportunism, etc., while, on the other hand, critical realism also accepts that reality in management and social research is a result of the perception and experimentation of social actors and is thus socially constructed (Bhaskar, 1978). Thus, these normative structures are affected by the influence of the perceptions of social actors, human agency and social mechanisms.

Critical realists further acknowledge that the actions and discourses of individuals are also influenced by underlying social (normative) structures as these structures can constrain or facilitate human actions (Mcevoy and Richards, 2006). Critical realism also recognises that the subjective interpretations of social actors are affected by existence of underlying causal mechanisms.

Corporate disclosure research has been criticised on the grounds of treating accounting information as a commodity. Parker (2007) argued that, in existing research, an excessive emphasis is placed on objective measurement of utility maximising behaviour, while the institutional, political and social context of research is reduced to variables, thus ignoring subjectivity altogether. Parker (2007, p.40) states that reality is socially constructed and so are accounting and disclosure practices. Therefore, it might be argued that, in accounting communication, the reality is not merely 'out there'. It is rather argued that the human thoughts, behaviours, practices and language used also play an important role in shaping reality. This research deals with this criticism by utilising critical realism, whereby objective structures and processes are studied along with recognition of the subjectivist standpoint.

Considering the fact that corporate governance literature has recently been criticised for its excessive dependence on positivist theoretical approach and over-utilisation of quantitative research methods (Parker, 2007; Othman and Rahman, 2011), critical realism also allows for an in-depth understanding of the influence of political connectedness on the disclosure practices of listed companies. It is argued that concepts mean different things to different people. Human behaviour is not an objective social fact; rather, it is influenced by the interpretations and the meanings assigned to the social world. The actions and reactions of human beings differ significantly when they are subjected to varying interests, locations and contexts (Bevir and Rhodes, 2001). The actions of social actors can be explained only if we look into their social context, their location, perceptions, interests and needs.



This research will take into account the complex nature of real world phenomena and will seek explanation of the phenomenon under research through an in-depth approach. As proposed by agency theory and rational choice institutionalism, it is argued that political interests might provide a motivation to members of the board of directors to engage in rent seeking and opportunistic activities. In order to hide these activities, they influence the quality of disclosures by listed firms.

The standpoint of critical realism is also in alignment with the theoretical underpinnings of this research. Agency theory recognises the existence of underlying structures and mechanisms (self-interest, utility functions, rationality), while rational choice institutionalism recognises the existence of institutions (such as political institutions) and institutional arrangements (such as corporate governance regulations) as normative social structures. However, rational choice institutionalism also recognises that social actors take strategic decisions after analysing their institutional environment, and that these decisions also affect the institutional environment. These theoretical perspectives give rise to the claim that agents (politically connected members of the board) are self-interested and opportunistic and will take advantage of information asymmetry between the stakeholders of the firms.

The current positivist research on agency conflict in corporate governance literature has attempted to explain the actions of agents (such as poor disclosure) on the basis of assumptions drawn from these claims. However, these claims, may not always be true. If, in a particular context, politicians act benevolently, instead of being opportunistic, and work in the best interests of their agents, the model developed on the claims of opportunism and self-

interest will provide no useful explanation of their actual behaviour (Hampsher–Monk and Hindmoor, 2010). Thus critical realist epistemology seeks to explain how social actors in a particular context perceive normative structures that are assumed to be given (independent of human perception) in positivist epistemology.

As argued by Maxwell (2004) the philosophy of critical realism allows for explanations to be sought in regard to phenomena, while exploring contextual factors qualitatively. Therefore, the use of critical realism here enabled the researcher to explore the impact of political connectedness on corporate governance disclosure. However, it is important to note that qualitative research is carried out in natural settings; that is, without controlling for various intervening variables. Guba and Lincoln (1989) argued that in natural settings, any single action is caused and affected by multiple actions and forces. Similarly, a single movement affects a multitude of other actions. This poses a difficulty in the determination of the causal influence of one factor/action on another. Guba and Lincoln (1989, p.151) state that:

*Everything influences everything else, in the here and now. Many elements are implicated in any given action, and each element interacts with all of the others in ways that change them all while simultaneously resulting in something that we, as outside observers, label as outcomes or effects. But the interaction has no directionality, no need to produce that particular outcome.*

It might be inferred from the above arguments that owing to the lack of control, although qualitative research provides explanations regarding the occurrence of events and indicates the existence of relationships between them, it has a

limited ability to measure precisely the extent and direction of such relationships. The purpose of the current research has been to establish a connection between political connectedness and corporate governance disclosure practices. However, this research has not made use of such techniques as probability sampling, the use of statistical techniques or correlational designs. Rather, this research has been carried out in complex and natural institutional settings. Therefore, this research has not controlled for various institutional factors that might also have an influence on the disclosure practices of listed companies. Although the findings of this research provide an indication that political connectedness influences the corporate governance disclosure practices of listed companies, the research does not provide an explanation regarding the extent and direction of the relationships between these variables. This limitation of the current study has been acknowledged in Chapter 7 and research involving a quantitative study exploring the direction of causal relationship between variables is intended to be carried out in future.

### **4.1.2 Research Approach – Deduction or Induction**

Another significant classification within the research onion (Figure 4.1) pertains to the extent to which deduction or induction is used as the research begins. Saunders et al. (2012) assert that deduction relates to the development of a rigorous theory, along with testable hypothesis at the beginning of the research project. Deductive enquiry is closely linked to scientific research. Research questions aim at testing the developed hypothesis. Induction, on the other hand incorporates development of theories from the findings of the empirical research. The theoretical underpinnings of the research are subject to

constant revisions, as theory, data and analysis are carried out in an iterative manner and keep on informing each other (Eriksson and Kovalainen, 2008).

However, in practice it is hard to stick to one particular classification for practical reasons; rather, it is beneficial to combine both approaches in a single research project (Saunders et al., 2012). This research identified the theories for informing the research questions. However, the propositions drawn from those theories were not considered be the *only* explanations for the research phenomena. Instead, the researcher had been open to accept any alternative explanations. Findings of the research have been arrived at through an iterative process, whereby theory, data and analysis continued to influence each other.

The propositions drawn from rational choice and agency theoretical perspectives provided a starting point for in-depth analysis. The propositions helped the researcher in determining the nature and framing of interview questions for in-depth investigation. However, the enquiry did not limit its focus to testing those propositions. Instead any possible alternative explanations were taken into account and an explanation was sought of how political influence affects the level of disclosures. The following section provides details of the data collection methods selected for conducting research.

### **4.1.3 The Design of the Research Project**

The third, fourth and fifth layer of the research onion (Figure 4.1) provide information about the design of this study. As stated by Saunders et al. (2012), the research design comprises of research strategy, choices and time horizons.

*Research strategy* should be developed so as to obtain effectively the answers to the research questions and to achieve the research objectives. In addition, the resources available for research, the context of research, the work done by other researchers in the field and the philosophical underpinnings of the research also influence the choice of research strategy (Saunders et al., 2012). Critical realism allowed for an investigation in the real life context of listed companies through the adoption of a case study strategy using multiple types of data and different analytical methods.

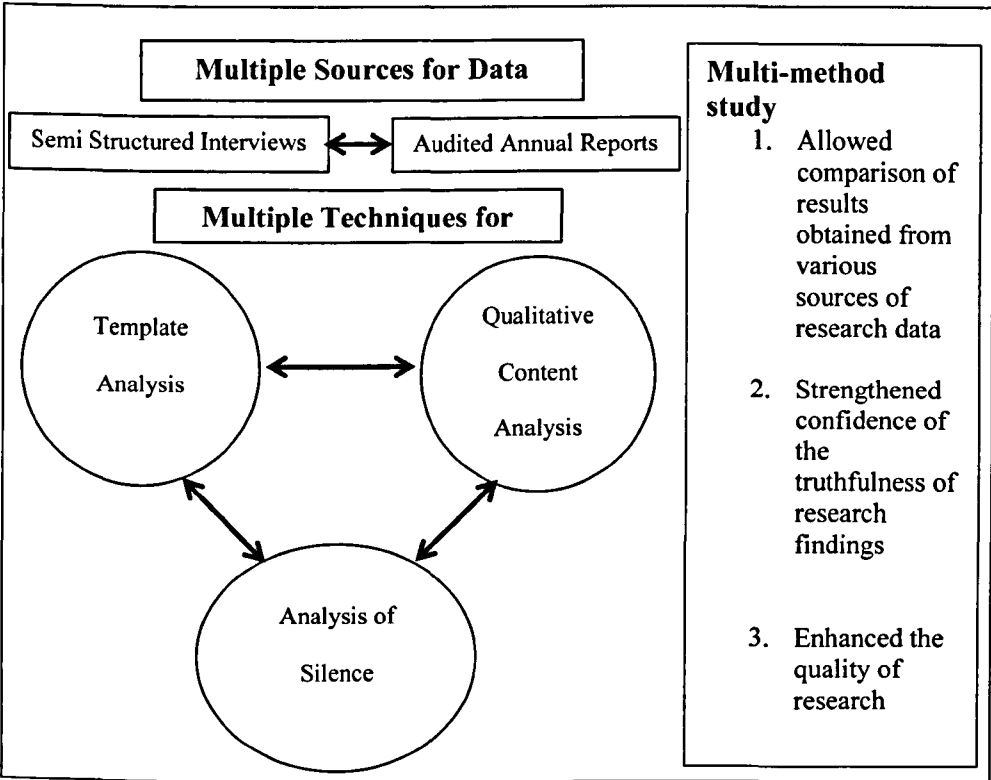
This research is a *multi-method* qualitative study as data were collected from various sources, such as annual reports and interviews, while different qualitative data analysis techniques were employed, such as qualitative content analysis, analysis of silence and template analysis. The use of multiple methods in this study provided an opportunity to obtain answers to the research questions and to improve the level of trust and credibility on the findings (discussed in detail in Chapter 7) drawn from the research.

*Longitudinal research* was conducted because the annual reports of 40 listed companies were analysed for the period of five years. The choice of a longitudinal design provided the benefit of gaining insights into the developments in the corporate governance disclosure practices of listed companies. It also provided the advantage of conducting a comparison between the level of disclosure amongst politically connected and non-connected firms over different reporting periods.

The use of multiple methods of data collection and analysis allowed for the triangulation of the findings of this research. *Triangulation* refers to the collection of data from multiple sources in a single study and is used for

seeking an assurance about the findings of the research (Saunders et al., 2012). The concept of triangulation is based on the argument that agreement in the results obtained from two different sources of data, which are measured independently, reduces the chances of the misinterpretation of data and eliminates uncertainty about the results obtained. Thus, triangulation enhances confidence over the results obtained (Bryman and Bell, 2011). Figure 4.3 shows how various methods of data collection and analysis were used in this research for the purpose of triangulation.

**Figure 4.3: The Use of Triangulation**



**4.1.4 Research Objectives and the Choice of Qualitative Research Methods**

An important decision regarding the research methods to be employed revolves around the choice of qualitative or quantitative methods for enquiry. The choice of qualitative or quantitative methods for research depends on the nature

of research questions and the purpose and objectives of the research (Punch, 2013). Quantitative research involves collection and analysis of numeric data, and large amounts of data are collected. Qualitative research typically involves an inductive approach to analysis and it attributes importance to the perceptions and interpretations of participants. As argued by Easterby-Smith et al. (2008), qualitative research contributes towards development of new theories or expansion of existing theories.

Since the nature of this study is exploratory as well as explanatory, a case study strategy proved best suited for enquiry. The aim of this study was to investigate the influence of political links on the disclosure practices of listed companies. It was then considered most appropriate to conduct an in-depth investigation of the disclosure practices of listed companies in the context of the country so as to enable a rich study. Many researchers have criticised existing corporate governance research for being overly quantitative and have called for more qualitative research in the field (McNulty et al., 2013).

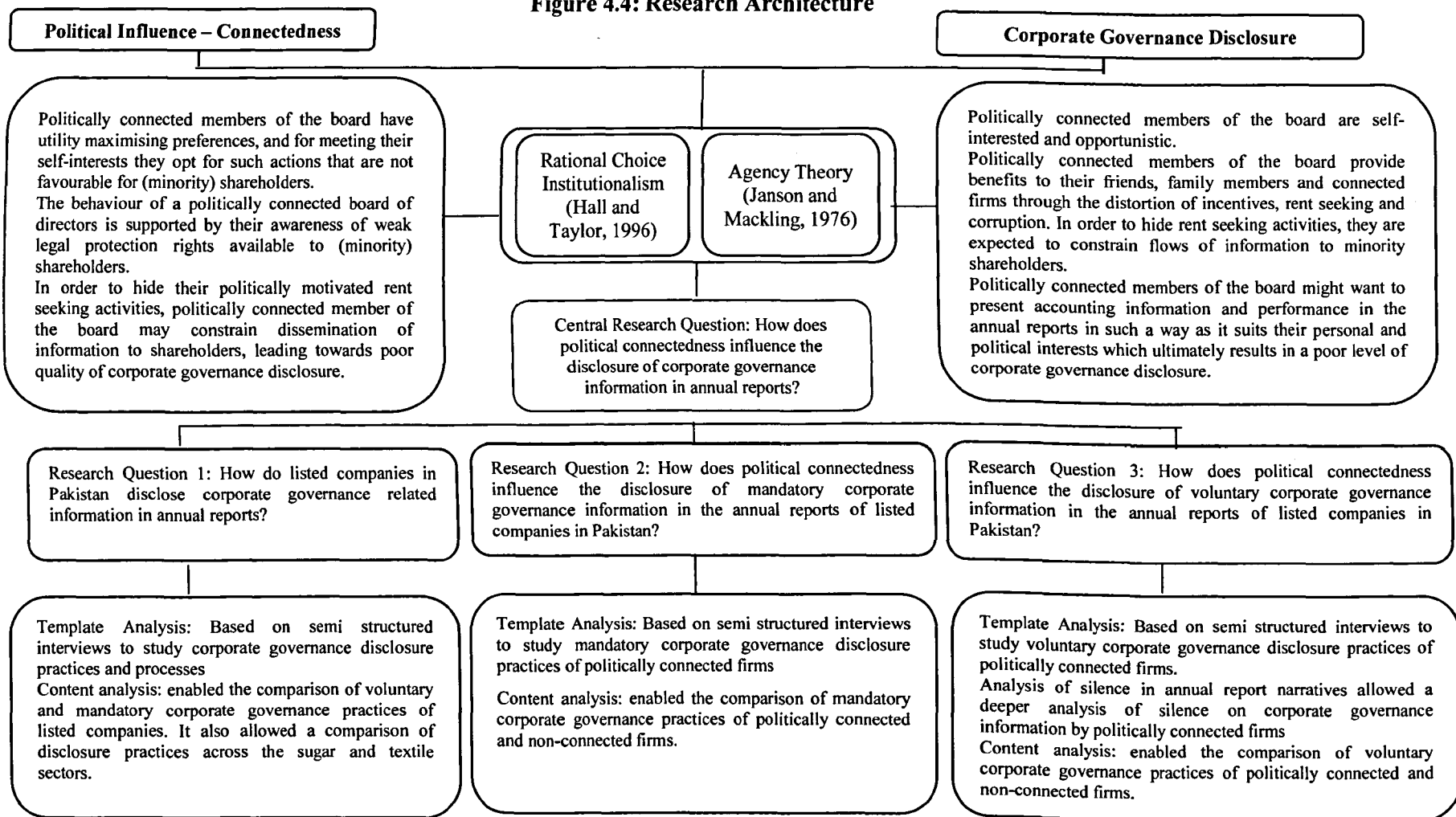
McNulty et al. (2013) argue that qualitative research is characterised by the collection of data in real life settings by the researcher, whereby multiple sources are used for data collection. Qualitative methods are used in this research project, based on the argument that qualitative enquiry generates deep understanding of human behaviour and actions, helps to extract meaning and explain the phenomena. In addition, qualitative research also allows for identification of unanticipated patterns in the data, whereas such unanticipated patterns are ignored for being overly simplistic in quantitative research (Buchanan et al., 2014).

Qualitative research allowed for the generation of an understanding of corporate governance disclosure practices, along with an analysis of the influence of political connectedness on these practices through an interpretation of annual report narratives and interviewing participants' accounts. The analysis of corporate narratives in annual reports was particularly useful, being that an increasing number of researchers now recognise that corporate narratives are not merely expressions of accounting performance; instead, they are drafted carefully to meet firms' strategic objectives (Merkl-Davies and Koller, 2012), enable impression management and facilitate the provision of additional useful information to the users (Merkl-Davies and Brennan, 2007; Cho et al., 2010). Thus, qualitative research helped in providing detailed explanation of the phenomena observed during the research (Pettigrew, 2013, p. 124).

Moreover, the collection and analysis of interview data exposed participants' perceptions regarding corporate governance disclosure practices of listed companies in Pakistan. Interview data analysis helped in the generation of useful inferences that provided answers to research questions and informed the theoretical underpinnings of the research. Figure 4.4 provides a model for this research.



**Figure 4.4: Research Architecture**



## **4.2 Data Collection Methods**

This research involved the collection of primary data through semi-structured interviews. The main source of the secondary data was the audited annual reports of listed companies from a range of sectors; namely, sugar, textile, chemical, food, leather, packaging, construction, paper, wool, synthetic products and miscellaneous. In order to strengthen the analysis of real life phenomena within the corporate context of Pakistan, secondary data available from media reports, economic publications and World Bank/international agencies' publications/reports were also taken into account, although they are not considered to be a major data source. The following section provides details of each of the data collection methods.

### **4.2.1 Audited Annual Reports**

Audited annual reports of listed companies were used for the purpose of analysis. Although it is recognised that annual reports are not the only source for corporate disclosure of companies; they provide an excellent source of information for the following reasons. Firstly, annual reports are considered to be the principal tool for the dissemination of corporate information from corporate organisations and are widely used as a data source for research into corporate disclosure (Wiseman, 1982). Annual reports are a mandatory document and all listed companies issue them. They are easy to access as they are a publicly available document. Secondly, annual reports are the most appropriate document for the analysis of mandatory disclosure in the context of Pakistan because Pakistan's Code of Corporate Governance (2002) requires that listed companies should provide, in their annual reports, a statement

disclosing their compliance with the mandatory requirements of corporate governance. Therefore, the annual reports of listed companies contain this disclosure statement. This statement thus proved to be a key document for analysis of mandatory corporate governance disclosures.

Thirdly, annual reports follow a standard format for various statements, which increases their comparability (Aljifri and Hussainey, 2007). As the objectives of this research called for a comparison of annual reports across various industries and also with respect to the status of political connectedness, it was most appropriate to analyse a document that was standardised and thus comparable. In addition, annual reports are the only low cost and readily available source of information available to investors in Pakistan (Ali et al., 2011).

Several prior studies on corporate disclosure have used websites as a source of data (Basuony and Mohamed, 2014; Alam and Rashid, 2014). However, here it was decided to exclude the analysis of disclosures provided on corporate websites. This decision was made because some of the companies in the sample did not have well developed websites. Although, in 2012, the Securities and Exchange Commission of Pakistan issued a notice to all the listed companies to maintain a fully functional website. However, the websites of some of the companies had not been created at the time the research was undertaken or were still under construction.

### **Audited Annual Reports – Selection of the Sample**

The objective of study was to analyse the disclosure practices of listed companies in Pakistan. Disclosure in annual reports can be divided into two

main categories: mandatory disclosure and voluntary disclosure. Following is an explanation of these categories.

### ***Voluntary Disclosure of Information***

Disclosures are deemed to be voluntary when the information is provided over and above the minimum regulatory requirements. Meek et al. (1995, p.555) define voluntary disclosures as “disclosure in excess of requirements, representing free choices on the part of company managements to provide accounting and other information deemed relevant to the decision needs of users of their annual reports.”

### ***Mandatory Nature of Disclosure***

Disclosures are termed as mandatory when the regulation makes it compulsory to reveal information on prescribed items. The provision of information over and above what is mandatory is called voluntary disclosure. Companies constituting the sample of the research were required to disclose all the items pertaining to mandatory disclosures. However, as demonstrated by previous research, owing to weak law enforcement and inadequate regulatory framework, compliance with corporate governance regulation was poor in the country and it could not be assumed that all the companies would disclose mandatory information.

The choice of research sample was influenced by the objectives of the research project. The annual reports for some of the companies were available on their websites. For the rest of the companies, hard copies of annual reports were obtained from their corporate offices. The annual reports of 40 listed companies are analysed.

The first question of the research focused on exploring the corporate governance disclosure practices of the listed companies. The aim was to assess the level and tendency of disclosure practices to understand the disclosure environment and prevailing disclosure trends in the capital market of Pakistan. Initially, data were analysed from 20 firms in the sugar and textile sectors. The research results from the data analysis of ten firms in the sugar industry were compared with the findings of data analysis from ten firms in the textile industry. This analysis was conducted in view of the high levels of political influence on the sugar industry, as reported by various media sources in Pakistan (Cheema, 2009; Malik, 2009). In order to eliminate industry bias in the research, it was decided to analyse annual reports from several different industries. Therefore, data were analysed from 20 additional firms from eight different sectors. Ten of these firms were politically connected, while the remaining ten firms were non-connected. The data from these 20 firms from several industries are termed as the ‘several sectors’ group in the thesis. Later on, research results from the several sectors group were compared with the earlier findings from the sugar and textile sectors. The analysis of data from several sectors helped in the enhancement of the rigour and robustness of the research findings. The analysis of data from various sectors also helped in the study of the disclosure practices of listed companies across industries.

In order to analyse the trends in the level of disclosure, annual reports were analysed for a period of five years; that is, from 2009–2013. Code of Corporate Governance was issued in 2002 in Pakistan, and until 2009, a period of seven years had lapsed after implementation of the Code. This period was chosen because a period of seven years was considered to be a reasonable time for the

development of an understanding regarding corporate governance principles by the listed companies and the subsequent development of a culture for disclosure in the capital market of the country. Furthermore, this period has provided the most recent insights into the disclosure practices of listed companies in Pakistan, thus entailing that research findings might have important policy implications.

Ownership structure is considered to have an influence on the disclosure practices of listed companies (Chau and Gray, 2002; Ali et al., 2007). In Pakistan, the capital market is dominated by family owned businesses<sup>24</sup> (Hasan and Butt, 2009); therefore, in order to ensure homogeneity in the ownership structure of the sample companies, all the companies chosen were family owned and controlled, so as to represent the capital market. Table 4.1 shows the corporate governance characteristics of the firms chosen.

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<sup>24</sup> International Finance Corporation (2011) defines a family owned business as a firm in which the controlling family holds the majority of voting rights. The controlling family consists of the founders of the firm with an intention of passing on the business to the next generation. This research uses the same definition for family firm.

**Table: 4.1 Characteristics of the Sample Firms (N=40)**

<b>Firm Name</b>	<b>Sector</b>	<b>Number of Directors in 2013</b>	<b>Number of Independent Directors in 2013</b>	<b>Ownership Structure</b>	<b>Status of Political Connectedness</b>
<b>Textile Sector</b>					
<b>T1</b>	Textile	7	0	Family Owned Firm	Connected
<b>T2</b>	Textile	7	1	Family Owned Firm	Connected
<b>T3</b>	Textile	7	1	Family Owned Firm	Connected
<b>T4</b>	Textile	7	1	Family Owned Firm	Connected
<b>T5</b>	Textile	7	1	Family Owned Firm	Connected
<b>T6</b>	Textile	9	3	Family Owned Firm	Non-Connected
<b>T7</b>	Textile	7	0	Family Owned Firm	Non-Connected
<b>T8</b>	Textile	7	1	Family Owned Firm	Non-Connected
<b>T9</b>	Textile	6	0	Family Owned Firm	Non-Connected
<b>T10</b>	Textile	7	1	Family Owned Firm	Non-Connected
<b>Sugar Sector</b>					
<b>S1</b>	Sugar	7	0	Family Owned Firm	Connected
<b>S2</b>	Sugar	9	1	Family Owned Firm	Connected
<b>S3</b>	Sugar	7	1	Family Owned Firm	Connected
<b>S4</b>	Sugar	7	0	Family Owned Firm	Connected
<b>S5</b>	Sugar	9	0	Family Owned Firm	Connected
<b>S6</b>	Sugar	9	1	Family Owned Firm	Non-Connected
<b>S7</b>	Sugar	8	0	Family Owned Firm	Non-Connected
<b>S8</b>	Sugar	8	1	Family Owned Firm	Non-Connected
<b>S9</b>	Sugar	8	1	Family Owned Firm	Non-Connected

**Table: 4.1 Characteristics of the Sample Firms (N=40)**

<b>Firm Name</b>	<b>Sector</b>	<b>Number of Directors in 2013</b>	<b>Number of Independent Directors in 2013</b>	<b>Ownership Structure</b>	<b>Status of Political Connectedness</b>
<b>S10</b>	Sugar	9	1	Family Owned Firm	Non-Connected
<b>Several Sectors</b>					
<b>SS1</b>	Wool	11	2	Family Owned Firm	Connected
<b>SS2</b>	Paper	7	1	Family Owned Firm	Connected
<b>SS3</b>	Construction	8	3	Family Owned Firm	Connected
<b>SS4</b>	Miscellaneous	8	0	Family Owned Firm	Connected
<b>SS5</b>	Chemical	11	0	Family Owned Firm	Connected
<b>SS6</b>	Chemical	7	1	Family Owned Firm	Connected
<b>SS7</b>	Leather	9	0	Family Owned Firm	Connected
<b>SS8</b>	Packaging	10	1	Family Owned Firm	Connected
<b>SS9</b>	Miscellaneous	7	0	Family Owned Firm	Connected
<b>SS10</b>	Synthetic	7	1	Family Owned Firm	Connected
<b>SS11</b>	Chemical	12	0	Family Owned Firm	Non-Connected
<b>SS12</b>	Chemical	10	2	Family Owned Firm	Non-Connected
<b>SS13</b>	Chemical	8	2	Family Owned Firm	Non-Connected
<b>SS14</b>	Food	8	0	Family Owned Firm	Non-Connected
<b>SS15</b>	Food	7	0	Family Owned Firm	Non-Connected
<b>SS16</b>	Food	8	1	Family Owned Firm	Non-Connected
<b>SS17</b>	Food	7	3	Family Owned Firm	Non-Connected
<b>SS18</b>	Packaging	9	1	Family Owned Firm	Non-Connected
<b>SS19</b>	Miscellaneous	7	0	Family Owned Firm	Non-Connected
<b>SS20</b>	Paper	9	1	Family Owned Firm	Non-Connected



Table 4.1 shows that 15 out of the 40 companies do not have an independent director on their board. The lack of independent directors indicates reluctance towards having credible role for independent director as a mechanism of corporate governance.

The second and third research questions focused on studying the influence of political connectedness on mandatory and voluntary corporate governance disclosures respectively. In order to address these questions, corporate governance disclosures in the audited annual reports of politically connected and non-connected firms were compared. In order to facilitate such a comparison, the main criterion that guided the choice of companies in the research sample was the status of political connectedness. Such listed companies were selected for content analysis where clear distinction could be established between politically connected and non-connected companies. A company having a politician as the member of its board was considered to be a politically connected company, whereby a politician is a person who participated in elections.

Table 4.1 shows that 20 of the firms in the sample were politically connected, while 20 were non-connected. In order to determine the political connectedness of a firm, the names of the board members were obtained from audited annual reports of the companies. The Election Commission of Pakistan (ECP) maintains the data for participation in elections in all national and provincial constituencies in Pakistan. Thus the lists of candidates participating in general elections for both national and provincial assemblies in the years 2002, 2008 and 2013 were downloaded from the ECP website. The first, middle and last names of the members of the board were then matched with the candidates who

had participated in the electoral process. In order to ensure that no politically connected firm was erroneously considered as a non-connected firm, only those firms were considered as non-connected where the name of none of their directors matched with any name in the electoral participation data. For those firms where the names of members of the board matched with a politician in electoral participation data, a further in-depth check was conducted through a detailed search by means of the Internet, company website, annual reports, newspapers and media. Thus, only those firms were considered politically connected where the political participation of the members of the board was established through these sources.

The following section provides an explanation for the choice of semi-structured interviews as an additional source of data.

#### **4.2.2 Semi-structured Interviews**

There are several types of interviews for example, formal, informal, structured, semi-structured or highly structured. The choice of the type of interview is informed by the research design and questions (Saunders et al., 2012). Semi-structured interviews are a useful research technique for exploratory and explanatory studies; that is, where the purpose of the research is to seek causes for the occurrence of events. Being that the purpose of this research has been to seek explanations regarding the influence of political connectedness on corporate governance disclosures, semi-structured interviews were conducted from the representatives of regulatory bodies, statutory audit firms and listed companies from the sugar and textile sectors. The following sections elaborate the choice of research participants and the process of interview data collection in detail.

### ***Choice of Research Participants***

A judgement sampling technique (Marshall, 1996) was used and participants were identified and selected so as to provide rich information that would help in the development of a deep insight into the phenomena researched. Marshall (1996) explained that a judgement sampling technique entails the selection of such participants who might be in a position to provide the most productive insights into the studied phenomenon, either because of their prior experiences or their subject knowledge and expertise. Another important characteristic of the judgement sampling approach is that research participants may introduce other useful and informative participants to the researcher. This research strategy requires intelligent decision making on the part of the researcher in order to choose the most appropriate participants for obtaining answers to the research questions.

The interviews for this research were conducted with representatives from listed companies in the sugar and textile sector, statutory audit firms and regulatory bodies. These in-depth interviews with the representatives of listed companies enabled the researcher to understand the perspectives of the companies regarding corporate governance disclosure in annual reports. The respondents from regulatory bodies were directly involved in the development of corporate governance regulations and the enforcement of listing regulations and the *Companies Ordinance (1984)*. All the respondents from the statutory audit firms were partners in those firms. The interviews from the partners of audit firms enabled the researcher to understand the perspective of those institutions regarding the current disclosure and compliance practices of listed companies. All the respondents were working at key positions in their

respective institutions. The position occupied by the respondents from listed companies meant that they would have a profound influence on the preparation of annual reports in their respective firms. All of the respondents had extensive experience of working in the corporate sector. Therefore, these participants were credible in terms of providing an opinion on the disclosure of corporate governance information in the annual reports. Following judgment sampling technique, these participants were chosen because they were considered to be professionally competent and experienced in the field of corporate governance and disclosure.

Table 4.2 provides information about the profile of the interviewees.

**Table 4.2: Profile of the Research Participants**

<b>No.</b>	<b>Organisation (Anonymised)</b>	<b>Position Held</b>	<b>Experience</b>	<b>Type of Organisation</b>
1	Listed Company Textile A	Company Secretary	15 years	Politically connected
2	Listed Company Textile B	Company Secretary	13 years	Politically connected
3	Listed Company Textile C	General Manager (GM) Finance	6.5 years	Non-connected
4	Listed Company Textile D	Deputy Financial Controller	7 years	Non-connected
5	Listed Company Textile E	Chairman and CEO	25 years	Non-connected
6	Listed Company Textile F	CFO	8 years	Non-connected
7	Listed Company Textile G	Director of Finance	40 years	Non-connected
8	Listed Company Sugar H	Company Secretary and CFO	22 years	Politically connected
9	Listed Company Sugar I	CFO	18 years	Non-connected
10	Listed Company Sugar J	CFO	12 years	Politically connected
11	Listed Company Textile K	Manager Accounts, Finance and Taxation	15 years	Non-connected
12	Statutory Audit Firm L	Partner	12 years	Statutory Audit Firm
13	Statutory Audit Firm M	Partner	14 years	Statutory Audit Firm
14	Statutory Audit Firm N	Partner	17 years	Statutory Audit Firm
15	Statutory Audit Firm O	Partner	23 years	Statutory Audit Firm
16	Statutory Audit Firm P	Partner	10 years	Statutory Audit Firm
17	Statutory Audit Firm Q	Partner	9 years	Statutory Audit Firm
18	Regulator R	Chief Operating Officer (COO)	20 years	Regulatory Body
19	Regulator S	Ex-Registrar	35 years	Regulatory Body
20	Regulator	Joint Director	12 years	Regulatory Body

### ***The Process of Interview Data Collection***

All the interviews were scheduled through e-mail and telephonic communication. An information sheet, along with the consent form, was provided to all participants. The information sheet stated the purpose of the research and assured the anonymity of the participant's name and the confidentiality of data. It was explained that the research did not involve any foreseeable risks to the participant. Appendix A provides research project information and consent form used for the purpose of obtaining informed consent.

Permission was sought for digital audio recording of the interviews and signed copies of consent forms were obtained from the participants. Interviews were conducted at the business premises of the participants. As the participants were senior managers, all of them were allocated separate rooms within the business premises, which helped in obtaining a clear and good quality recording. It also allowed the participants to talk freely and confidentially.

Each interview began with an introduction of the researcher to the participant. The researcher then informed the respondent orally about the time limit and the purpose of the project. The researcher also informed the participant about the conditions of confidentiality. The researcher asked the participant about his/her role and responsibilities for the specific job which he/she carried out for the organisations, how long he/she has held the position and what was the level of his/her authority in the organisation.

Appendix B provides a copy of the outline guide developed by the researcher for this purpose. The interview guide helped the researcher to cover the topics that needed to be covered for understanding research phenomena. The

interview guide also prevented the researcher from losing focus. The researcher followed the guide in all the interviews. However, the researcher also explored certain conversation trajectories that were felt appropriate for understanding certain phenomena. The interview guide prepared initially was then sent to two experts in the field of corporate governance in Pakistan and their advice was sought on the suitability of questions, considering the prevailing institutional context in Pakistan. The interview guide was thus further refined after obtaining their feedback, as it proved to be very useful in the improving interview guide.

Most of the interviews were conducted in English. However, some participants could not speak fluent English and, in order to ensure a good flow of information, a few interviews were conducted in Urdu (Pakistan's national language). On average, each interview lasted for approximately 45 minutes. The interviews were transcribed verbatim. In order to ensure a timely management of work load, transcription services were acquired from a Pakistan-based company for some of the interview data. The purpose of using a local transcription company was to ensure accuracy in translation as the translators/transcribers understood the context in which certain terms were used. The quality of all the transcripts was cross-checked and the researcher reviewed each transcript at least twice against the recorded interview.

The process of interview data collection started with the generation of access to the interview participants. Following transcription of the interviews, template analysis of the data was conducted. The data were interpreted to understand how they informed initially developed research propositions. During this phase

of interpretation, some of the research participants were contacted again to seek additional insights into some of the aspects of their earlier statements.

The following section will elaborate the choice of the methods used for analysis of research data.

### **4.3 Data Analysis**

The choice of data analysis technique should be consistent with the research philosophy. This research utilised the technique of qualitative content analysis for evaluating the level of disclosure in annual reports. In order to obtain an in-depth understanding of the disclosures, silence on corporate governance disclosures in annual report narratives was also analysed. Template analysis was used for the analysis of interview transcripts. Qualitative data analysis software (NVivo) was used to assist in the process of data analysis. The following sections elaborate the methods used for the analysis of research data.

#### **4.3.1 Qualitative Content Analysis**

Elo and Kyngäs (2008, p. 108) define content analysis as a systematic and objective method for describing and quantifying written and spoken phenomena. Bruce and Lune (2014, p. 242) argue that items in content analysis of the text are counted for “identifying, organising, indexing and retrieving data.” They further state that due consideration should be given to the literal meanings of the text and the context and manner in which these words are used. According to this perspective, the purpose of content analysis is to collate the data in an organised form so as to facilitate interpretation and analysis by the researcher.



In accordance with the views of Bruce and Lune (2014), this research has utilised qualitative content analysis. Qualitative content analysis goes beyond the quantification of texts through word frequency counts. Instead, it focuses on understanding social reality through analysis of texts in a subjective manner. Qualitative content analysis allows for the examination of underlying meanings embedded in the text. It provides the researcher with descriptions of how the producers of the text construct their social world (Zhang and Wildemuth, 2009).

Therefore, the technique of qualitative content analysis harmonises well with the philosophical underpinnings of this research. In addition, the choice of qualitative content analysis was appropriate for obtaining answers to the research questions. The technique not only allowed for an examination of disclosure practices of the listed companies, but also for a comparison of the level of corporate governance disclosures across politically connected and non-connected firms.

Bruce and Lune (2014, p. 242) argue that there are two main categories of content analysis; that is, manifest analysis and latent analysis. They described these categories in the following manner. Manifest content analysis refers to the surface analysis of the data, organised through word counts. Latent content analysis refers to the interpretation of data beyond the manifest characteristics. The researcher looks for the presence of in-depth meanings in the data through an analysis of the structural elements of the text. Bruce and Lune (2014, p. 243) advocate the use of both manifest and latent content analysis methods in research, as word frequencies do not reflect the nature of data, and so a researcher has to look into latent meanings to generate useful interpretations.

This research has examined the level of the disclosure using a binary scheme for coding corporate governance disclosure. In the case of an absence of information on a corporate governance attribute, a score of 0 was attributed, while a score of 1 was attributed in the case of presence of the information. Later on, an in-depth analysis of narratives was performed to develop an understanding of disclosures across the various dimensions of corporate governance. Patterns of similarity and difference were identified across both industries, while explanations for variation in patterns of disclosure were also sought. This in-depth analysis allowed the development of a rich understanding of disclosure practices and the context in which these practices were performed.

Zhang and Wildemuth (2009, p.2) explain that the process of content analysis can be based in the context of either inductive or deductive reasoning. In research based on inductive reasoning, the researcher can develop themes from the data. However, in the case of deductive research, themes and categories are initially developed from a theory. Later on, the researcher adds or deletes the categories as they emerge out of the data.

Initially, this research developed propositions from existing theory using a deductive strategy, whereby the initial categories were developed from existing literature. However, as the research progressed and researcher started the data analysis, new categories were added and some of the initial categories were deleted or merged. Zhang and Wildemuth (2009, pp. 4–5) outline a detailed process of qualitative content analysis, using the following eight steps:

- *Preparation of data:* decision on the choice of the content to be analysed and transcription of data.

- *Define the unit of analysis*: either individuals, themes, ideas or concepts are to be analysed.
- *Develop categories and a coding scheme*: categories are developed from the theory used, the data or from other relevant studies.
- *Testing the coding scheme*: a pilot may be conducted to test the validity of the coding scheme.
- *Code all the text*: once the pilot is conducted and consistency achieved in the coding scheme, all of the data will be coded.
- *Assessment of coding consistency*: verification of the consistency in coding scheme, to ensure once again that all the data were coded in a consistent manner and according to the initially defined coding rules
- *Draw conclusions from the coded data*: Revisiting the coded data again and again to draw meaningful inferences, leading to conclusions and findings.
- *Reporting research methods and findings*: Report detailed research process and findings truthfully to allow replicability.

The above process outlined by Zhang and Wildemuth (2009, pp. 4–5) was used as a guideline to carry out analysis in this research. The following is an elaboration of the process of qualitative content analysis followed by the researcher.

### ***Preparation of Data***

As elaborated in Section 4.2.1, the narrative section of annual reports of 40 listed companies were analysed for a period of five years; that is, from 2009 to 2013. Twenty of these companies were politically connected, while the rest of the companies were non-connected.

### ***The Unit of Analysis***

The unit of analysis refers to the basic unit of text to be coded during the process of content analysis (Zhang and Wildemuth, 2009, p. 3). Zhang and Wildemuth (2009) further explain that defining the unit of analysis is one of the most important decisions in content analysis, as the choice of the unit of analysis ultimately affects the comparability of the study with other similar researches. Previous studies using a content analysis technique have used a number of different units of analysis, such as the number of words (Jing et al., 2008; Al-Najjar and Abed, 2014), the number of sentences (Mazurina Mohd and Taylor, 2014), the space occupied on a page (Dagiliene, 2010) and a theme or construct (Green and Graham, 2005; Gunawan and Hermawan, 2012).

However, Zhang and Wildemuth (2009) argue that qualitative content analysis usually entails the use of a theme as a unit of analysis and the use of words, sentences and percentage of page space are often used for quantitative studies. Therefore, a theme was used as the unit of analysis in this research. Every instance providing governance-related information in the annual reports was considered as the occurrence of a theme. All such instances were thus recorded, whether they were expressed in a word, sentence or paragraph in the document.

### ***Development of Categories of Corporate Governance***

In the beginning of this research, a detailed review of the literature was conducted (see Chapter 3). The review of existing literature helped in the development of the constructs for corporate governance disclosure. The constructs/categories of corporate governance practices developed by Green and Graham (2005) were combined with the components of corporate governance listed down by Maingot and Zeghal (2008) for the development of

a basic categorisation structure for corporate governance disclosure. The adoption of the coding scheme used by previous studies yielded the advantage of increased comparability of research findings across relevant studies. The following categories served as the basis of content analysis: (1) accountability; (2) independence; (3) roles, responsibility and inter-relationships; (4) profile; and (5) executive/director remuneration. This initially developed categorisation scheme was further refined and separate categories were developed for voluntary and mandatory disclosures (as defined in Section 4.2.1).

Zhang and Wildemuth (2009) recommend that a coding manual should be developed for ensuring consistency in the coding scheme. The coding manual should provide the names of the categories along with the definitions and rules for coding. Therefore, two coding sheets were prepared. Each of these coding sheets outlined voluntary and mandatory disclosure items under the following categories: accountability, independence, roles, responsibility and inter-relationships, profile and executive/director remuneration. Existing literature helped in the development of an initial voluntary corporate governance disclosure coding sheet. Additionally, the coding sheet was adjusted to fit to the Code of Corporate Governance (2002). Later on, additional items were added following a pilot study of four randomly selected annual reports from the research sample. The number of total voluntary disclosure items is 39. Table 4.3 provides details of the coding manual prepared for voluntary corporate governance disclosure.

**Table: 4.3 List of Voluntary Governance Disclosure Items****Accountability**

- |   |   |
|---|---|
| 1 | Responsibility regarding shareholder value creation.            |
| 2 | Accountability regarding strategic decision making.             |
| 3 | Responsibility of boards towards compliance.                    |
| 4 | Responsibility towards provision of information and disclosure. |

**Independence**

- |    |   |
|----|---|
| 5  | Separate role of CEO and Chairman.                          |
| 6  | Number of independent directors.                            |
| 7  | Independence of audit committee.                            |
| 8  | Chairman of the audit committee is an independent director. |
| 9  | Composition of HR and Remuneration Committee.               |
| 10 | Board has formed HR and Remuneration committee.             |
| 11 | Independence of Human Resource Committee.                   |

**Roles, Responsibility and Inter-relationships**

- |    |  |
|----|--|
| 12 | Number of directors.   |
| 13 | Duties of the board.   |
| 14 | Board meeting attendance details.  |
| 15 | Board approves corporate objectives. Management has to meet those objectives.  |
| 16 | Board reviews CEO performance.   |
| 17 | Board has developed a procedure for determining the effectiveness of the board and board committees. Board's own performance evaluation. |
| 18 | Board's approval for company's risk management practices.  |
| 19 | Responsibility for succession planning.  |
| 20 | Responsibility towards integrity of internal controls.   |
| 21 | Policy on election of institutional investors (if any).  |
| 22 | Number of directorships held in other companies.   |
| 23 | Disclosure of interest in buying, selling or other transactions in company shares.   |

24	Disclosure of interest and association with the recipients of donations made by the Company.
<b>Profile</b>	
25	Name.
26	Residence.
27	Occupation.
28	Number of years on board.
29	Qualification of directors. Their skills, competence, knowledge, experience and diversity.
30	Biography.
31	Photographs.
32	Qualification of CFO and Head of internal audit.
<b>Executive/ Director Remuneration</b>	
33	CEO salary with break-down.
34	Number of shares held by CEO.
35	Loans to CEO.
36	Directors' salary with break-down
37	Number of shares owned by directors.
38	Loans to directors.
39	Information on procedure for fixing of board's salary.

The Code of Corporate Governance (2002) served as a basic document for the preparation of the coding manual for mandatory disclosure items. The Code of Corporate Governance (2002) requires that each listed company should publish and circulate a statement of compliance with the requirements of the Code of Corporate Governance along with the annual report. A specimen statement for compliance with the Code is also annexed to the Code. Drawing upon the Code of Corporate Governance (2002) and the annexed specimen statement, a list of governance specific mandatory items was then prepared.

The coding sheet so prepared comprises of 26 disclosure items. Table 4.4 provides the list of items constituting the mandatory disclosure coding sheet for the study.



**Table 4.4: List of Mandatory Governance Disclosure Items**

<b>Accountability</b>	
1	Complete record of particulars of significant policies along with the dates on which they were approved or amended has been maintained.
2	All the powers of the board are duly exercised regarding decisions on material transactions.
3	Directors' report is prepared in compliance with the requirements of the Code and discloses all salient matters.
<b>Independence</b>	
4	Board authority for hiring/firing of CEO.
<b>Roles, Responsibility and Inter-relationships</b>	
5	Composition of the board – balance of executive and non-executive directors and those representing minority shareholder interests.
6	Directorships held in not more than ten companies.
7	None of the directors is a defaulter.
8	Casual vacancy created on (date)
9	Number of days for filling up of casual vacancy for director's position.
10	Preparation and dissemination of company's code of ethics or conduct.
11	Development of vision/mission statement.
12	Board meetings were presided over by the Chairman or, in his absence, by a director elected by the board for this purpose.
13	Number of board meetings.
14	Circulation of notice regarding board meeting along with the agenda and working papers.
15	Recording and circulation of minutes of board meetings.
16	Provision of opportunities for directors' training and development programmes.
17	The board has approved appointment of CFO, Company Secretary and Head of Internal Audit, including their remuneration and conditions of employment.

18	The Directors, CEO and executives do not hold any interest in the shares of the company other than that disclosed in the statement reporting pattern of shareholding <sup>25</sup> .
19	Board had formed audit committee.
20	Composition of the audit committee.
21	Number of the meetings of the audit committee.
22	The terms of reference of the audit committee have been formed and advised to the committee for compliance.
23	The board has set up an effective internal audit function.
24	Independent and satisfactory statutory audit function.
<b>Profile</b>	
25	Corporate governance training attended by board members.
<b>Executive/ Director Remuneration</b>	
26	Decision on remuneration and terms and conditions of employment of the CEO, other executives and non-executive directors has been taken by the board/shareholders.

<sup>25</sup> The Pakistan Code of Corporate Governance (2002) requires that the companies must disclose a pattern of shareholding providing the aggregate number of shares held by various shareholders including executives, directors, their spouses and minor children (name-wise details).

### ***Coding***

The binary coding scheme used by Maingot and Zeghal (2008) was applied for content analysis. A positive rating of 1 was given to the listed company if it disclosed the item in question. In the case of the absence of information, the company received a rating of 0.

### ***Assessment of Coding Consistency***

The coding consistency was validated at two different stages. In the first stage, a pilot study was conducted before coding the whole data. The data from four annual reports were coded. The results from the pilot were assessed and certain items were added and deleted from the initially developed coding sheets. Later on, the rest of the annual report data were coded. After completing the coding of data from all annual reports, the consistency of the coding scheme was reviewed one more time. It was ensured that all the data were coded in a consistent manner and according to the initially defined coding rules. In order to confirm the content validity of the coding sheet, two UK academics also reviewed the pilot study and it was thus confirmed that the coding scheme satisfactorily captured the aspects of the research phenomena under investigation. Accordingly, the resulting coding manuals were deemed rigorous and reliable in capturing the voluntary and mandatory disclosure practices in companies' annual reports.

### ***Draw Conclusions from the Coded Data***

This step involved making sense of the coded data. Patterns of disclosure were identified and inferences were drawn regarding the disclosure practices of the listed companies. Variation in the level of disclosure was analysed across various disclosure categories and explanations were sought regarding this

variance. Variation in the disclosures provided by politically connected and non-connected firms was also analysed and conclusions were drawn from this analysis.

### ***Reporting Research Methods and Findings***

The researcher has reported the findings from the content analysis using tables and diagrams providing research results. This description of data is supported by an interpretation of the variation in disclosures and patterns identified in the data. Interpretation of research data is supported by reference to the theoretical underpinnings of the research. It is therefore explained where the data supported initially developed theoretical standpoint and how this research makes a theoretical contribution to the existing literature.

#### **4.3.2 Analysis of Silence in Annual Reports**

This section provides the meaning and explanation of the concept of silence. Researchers have recognised silence as a mechanism for the hiding or concealment of information. This section also elaborates how silence in communication has been studied by earlier researchers in the fields of corporate and political communication. It might be explained that although silence has been studied as a distinct tool for analysis in political communication, its use in the study of corporate communication is recent. Furthermore, this section justifies an analysis of silence as an additional, appropriate methodological tool for the study of corporate governance disclosure in annual reports of politically connected firms.

### ***The Concept of Silence***

Silence is often defined as an absence of speech, although the role of silence in communication is considered as important as speech (Ehrenhaus, 1988; Paulston et al., 2012). Silence has been studied in a large variety of disciplines, such as linguistics, health sciences, psychology, anthropology, linguistics, political science, business and organisational studies. The literature on silence suggests that silence occurs when the receivers of the information are neither provided adequate information nor are they provided any signal that might help them comprehend the information provided.

A large number of studies on silence argue that silence is used as a tool for resistance (Maclure et al., 2010), maintaining status quo, communicating existence of power relationships and protest (Jungkunz, 2012). Another type of silence characterises absence of speech when something is expected to be talked about at a particular place or occasion (Paulston et al., 2012). The silence in such a case is strategic and meaningful.

Ephratt (2011) argues that silence performs the functions of revealing and hiding information. In some cases, information is provided while one remains silent, but in other cases, one speaks without delivering any information at all through the use of empty speech. Ephratt (2011) states that ‘empty speech’ is speech that is meaningless. In empty speech, the narrator speaks words without saying anything meaningful or useful. This strategy of not saying the expected is deliberate.

### ***Study of Silence and Concealment in Political Communication***

The literature on political science has recognised the importance of silence in political discourse. Schröter (2013) argues that the study of what remains

unsaid is highly important in the analysis of political discourse. Bull (2003) found that politicians use silence as a strategy to deal with unfavourable questions. As argued by Schröter (2013), in political communication, some of the viewpoints are made implicit so as to suppress information on other alternative viewpoints. Information on these alternative viewpoints is not desirable and thus these subjects are side-lined. Thus, when one issue is over-emphasised in political discourse, it may imply that information on some other issue is concealed through silence. Schröter (2013) further argues that such silences can be identified through a deeper analysis of political communication, while silence in communication occurs when one does not intentionally communicate relevant information when expected to speak.

Brummett (1980) studied strategic silence in politics. It was argued that silence is strategic when it breaches expectations. Brummett (1980) further argued that the public attributes meanings to that silence and silence is intentionally directed towards some audience. It was argued that politicians use silence as a political strategy for expression of mystery, uncertainty and passivity.

Schröter (2013) explained that there is a small number of studies on the analysis of silence in the literature on political communication, and stressed that there is a need for more empirical research in the field. This research analyses the silence in the annual reports of politically connected firms through a comparative analysis of corporate governance narratives in politically connected and non-connected firms.

***Study of Silence in Corporate Communication***

Existing literature on the analysis of disclosure in annual reports argues that companies use narrative sections in annual reports for promoting a positive impression regarding company affairs, whereas negative information is ignored or under-emphasised. Corporate silence or non-disclosure of information is thus used as a tool to flee from assumption of responsibility (Buhr, 2001; Brennan et al., 2009).

As explained above, the use of analysis of silence as a method for the study of corporate communication is recent. However, a few studies in corporate communication have analysed silence. Chwastiak and Young (2003) studied how corporations use silence as a tool to hide the negative impact of corporations' environmental losses in corporate annual reports. Chwastiak and Young (2003) emphasise the need to break these silences in corporate communication so as to save earth from the negative environmental practices of corporations.

Hollander et al. (2010) studied the silence of managers in corporate communication and found that managers provided incomplete disclosure and did not release adequate information to investors during conference calls. Therefore, the provision of inadequate information or what remains unsaid is recognised as a tool used by both politicians as well as corporate managers. This research is an empirical investigation of the same phenomenon.

It might be argued that, according to the positivist perspective, structures such as corporate governance and disclosure regulations, rationality, utility functions and self-serving behaviour exist as normative constructions and influence the disclosure practices of listed companies. However, various researchers argue

that accounting information is socially constructed and corporate disclosures are prepared under the influence of perceptions of the preparers of annual reports (Buhr, 2001). Organisational actors therefore, take the decisions regarding disclosure/non-disclosure of information based on their own perceptions. The viewpoint of critical realism takes both of these arguments into account, and suggests that the choices regarding inclusion or exclusion of any particular piece of information might be shaped by social conditioning, as well as by existing normative structures. The analysis of silence so allows for the study of corporate governance disclosures both from positivist as well as social constructionist standpoints.

### *Analysis of Silence*

Considering the initially developed research propositions drawn from agency theory and rational choice institutionalism, the analysis of silence was considered to be the best suited technique for gaining in-depth understanding of research phenomena. According to these theories, self-interest and the opportunism of board members might result in poor disclosure and in order to hide their rent-seeking activities, members of the board constrain the dissemination of information to minority shareholders, leading to limited corporate governance disclosure.

This research analysed audited annual reports of companies to generate an understanding of the disclosures made therein. It focused on the instances where the annual reports remained either completely silent or provided alternative information, so failing to address the actual question/subject on which they were expected to provide information. Existing research on silence argues that such techniques are used when the narrators want to avoid, deny or



deflect from the topic under discussion (Morison and Macleod, 2013). For the purpose of analysis of annual report data, the following steps were followed:

- First, the parts of the annual reports covering information on corporate governance practices were identified.
- The parts containing information on corporate governance were read iteratively.
- Politically connected and non-connected reports were classified. A politically connected firm being one having at least one politician on its board.
- The iterative reading eventually led to the determination of similarities and differences in the information provided in regard to corporate governance practices in the annual reports of politically connected and non-connected firms.
- It was then analysed whether the corporate governance information was totally absent or empty speech was used for concealment.

The following chapters provide a description of the process of application of qualitative content analysis and the analysis of silence along with an explanation of the results drawn from these techniques of analysis.

#### **4.3.3 Analysis of Interview Data**

Qualitative research provides an element of flexibility in development of theoretical propositions, data collection and data analysis as the researcher keeps on revisiting each of these areas as the research process progresses. The analysis of interview data gives rise to the emergence of new themes and categories, those that might not be taken into account in the phase of

development of propositions and initial data collection. Alternative propositions may then be developed, with the subsequent data collection process thus continues, under the influence of newly developed propositions (Saunders et al., 2012).

This research used existing theories to inform research propositions and provide possible explanations for the researched phenomena, but the scope of data analysis was not limited to examining the explanatory power of those propositions. A fairly flexible approach was instead adopted and the researcher remained open to consider any alternative explanations of the phenomenon. Saunders et al. (2012) explain that various techniques can be used for qualitative data analysis such as grounded theory, narrative analysis, etc. However, the technique of ‘template analysis’ was utilised for the purpose of the interview data analysis performed here.

### ***Template Analysis***

The interview data was analysed using the approach of ‘template analysis’ provided by Saunders et al.(2012). Saunders et al.(2012) defined a template as a list of categories derived from data, after performing a thematic analysis on it. This technique was chosen as Saunders et al. (2012) explained that template analysis allows the researcher to combine the deductively developed propositions with the inductively developed themes and categories from the interview data. Template analysis enabled the researcher to identify the relationships and develop hierarchies between the themes and categories. The use of template analysis also helped the researcher in seeking explanations regarding the phenomena researched in the light of the propositions developed.

The use of this technique enabled the researcher to obtain answers to the research questions through an analysis of the themes developed from the theoretical propositions informed by agency theory and rational choice institutionalism. In addition to verification of the initially developed propositions, template analysis also allowed the researcher to identify any new themes emerging in the interview transcripts. The following section provides a description of the process of template analysis.

**a. Categorisation**

This stage involved the identification of the ‘categories’ from interview transcripts. The groups of data were labelled using these categories in order to provide a structure for further analysis. The arrangement of these categories was directed by the theoretical propositions of the research project. However, the researcher did not limit these categories to the pre-established propositions. Any important themes that emerged from the data were identified and considered so that the answers to the research questions were pursued in the most appropriate manner. Since NVivo was used for the purpose of analysis, the categories were represented by the nodes in the software. Table 4.5 contains the template representing the most important categories that emerged from the analysis.

**Table 4.5 Template Analysis**

1.	Preparation of Annual Reports – The Process
2.	Role of Directors in Preparation of Annual Reports
3.	What to Disclose in Annual Reports? — Financial Information
4	Good Disclosure means Mandatory Disclosure
5	Mandatory Disclosure – Monitoring and Compliance
6	Drivers Underlying Reluctance to Corporate Governance Disclosure
7	Political Connectedness and Mandatory Disclosure
8	Political Connectedness and Truth and Fairness of Mandatory Disclosure
9	Political Connectedness and Voluntary Disclosure
10	Voluntary Disclosure is not Useful

### **b. Unitising**

This step involved the allocation of relevant portions of transcripts under each of the categories/nodes. The identified sections of data were allocated to the relevant nodes. This approach helped to organise data in a manner so that the resulting display of data would provide a better understanding regarding the phenomena researched.

### ***Development of Categories***

This stage of data analysis involved the identification of relationships between various categories. Various themes emerging from the data were analysed and re-analysed and their allocation to various categories changed as the process of analysis continued. Some of the previously identified categories were

eliminated, while some new categories also emerged as the analysis progressed. Meaningful relationships between categories were established so as to obtain the answers to the research questions.

**c. Testing of Propositions**

The analysis of the research data provided insights into the initially developed research propositions. Alternative explanations for various relationships were sought. These alternative explanations to the research problem were helpful in enabling the researcher to reach useful findings regarding researched phenomena.

It is important to note that the methods of qualitative content and template analysis appear to share many similarities. However, a number of differences exist between these techniques. Firstly, the process of interpretation in template analysis always places the emphasis on research context. However, qualitative content analysis runs the risk of losing focus on the context. Secondly, the categories in qualitative content analysis are based on the frequency of their occurrence. On the other hand, the categories in the template analysis have been developed on the basis of conceptual and thematic mapping. Furthermore, content analysis entails a peer review in order to ascertain consistency in the coding scheme. In contrast, thematic analysis does not generally require a peer review (Vaismoradi et al., 2013).

**4.4 Ethical Considerations**

Ethics in the context of research, refer to the rules that guide researchers in respect to their responsibilities towards other parties (Chalk et al., cited by

Kimmel, 1988). Since this research activity involved human participants, ethical issues were of considerable importance.

Being that the participants in the research were senior level managers, gaining access to them was the most critical practical issue. The researcher hence sought permission from each participant for the use of a digital recorder and for note-taking. The research data were collected after obtaining consent from the research participants. Appendix A provides the ‘research project information and consent form’ used for the purpose of obtaining informed consent. Anonymity and confidentiality of responses were ensured to all participants, while every possible precaution was taken in protecting the confidentiality of the research data.

Pseudonyms were used for the purpose of securing confidentiality for research participants. The researcher made every possible effort to keep the data safe from unauthorised access, accidental loss or destruction. The provisions of the UK Data Protection Act 1998 and Freedom of Information Act 2000 were followed.

The researcher took due care to protect the participants from all types of psychological distress and physical risks, although it was not anticipated that any such issues would need to be addressed. The methods of data collection and analysis were chosen so as to provide accurate results. As far as possible, no personal bias affected the writing up of the research findings. Ethical approval was also obtained from the Open University Human Research Ethics Committee (Appendix C) for conducting this research.

#### **4.5 Conclusion**

This chapter has outlined the design of the proposed research. Various philosophical approaches were discussed and a suitable methodological position was used for investigation. The reasons for proposing a qualitative research design incorporating two methods for data collection and three different methods for data analysis have been outlined. This research used interviews and audited annual reports as methods of data collection, while the use of the techniques of template analysis, analysis of silence and qualitative content analysis have been explained, in terms of their being tools used for the analysis of the research data.

## **Chapter 5 – Interpreting the Annual Report Data**

### **5.0 Introduction**

Chapter 2 of this thesis outlined the institutional background for this research. Chapter 3 provided a detailed account of prior literature in the field of corporate governance disclosures, along with an explanation of the theoretical underpinnings of this research. Chapter 4 outlined research philosophy and methodology and elaborated the methods to be used for data collection and analysis. As explained in Chapter 4, in order to understand the impact of political connectedness on corporate governance disclosure this research used two main sources of data, that is, audited annual reports and semi structured interviews.

This chapter will provide a detailed analysis of annual report data, whereby voluntary as well as mandatory corporate governance disclosure practices of politically connected and non-connected listed companies in Pakistan were examined. Audited annual reports have therefore been analysed using two methods; that is, qualitative content analysis and the analysis of silence.

Figure 5.1 below shows the structure of the thesis.



**Figure 5.1: Chapter 5 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan's Institutional Context: Relevance to other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
<b>Methodology</b> Selection	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical Considerations</li> <li>– Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The Influence of Political Connectedness on Corporate Governance Disclosures</li> <li>– Conclusion</li> </ul>
<b>Findings and Conclusion</b>	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>

Section 5.1 of this chapter elaborates the results of qualitative content analysis. Analysis was undertaken on the annual reports of 40 listed companies for a period of five years; that is, from 2009 to 2013. For the purposes of comparison, 20 of the companies in the sample were politically connected, while the remaining 20 companies were non-connected. Qualitative content analysis was undertaken to investigate voluntary as well as mandatory corporate governance disclosure practices in audited annual reports. Qualitative content analysis proved to be a useful tool for analysis, being that it helped in the identification of differences in the disclosure practices of politically connected and non-connected companies.

Section 5.2 provides results of the analysis of silence. Silence on corporate governance information has been analysed in the same annual reports. The analysis of silence allowed the researcher to examine in-depth what remained unsaid regarding the companies' corporate governance practices in the annual reports. It also helped in the identification of such instances where text has been provided without providing relevant and meaningful information regarding corporate governance practices of the firms.

Section 5.3 offers some conclusions.

### **5.1 Qualitative Content Analysis**

As indicated in Chapter 4, several studies on the analysis of disclosure in annual reports have used the technique of content analysis (Green and Graham, 2005; Maingot and Zeghal, 2008). The process of content analysis outlined by Zhang and Wildemuth (2009, pp. 4–5) was used as a guideline for the analysis performed in this research, as it was considered to be the most appropriate method for investigating the research phenomenon. The following sections

elaborate how qualitative content analysis addressed the various sub-questions examined by this research.

### **5.1.1 Level of Disclosure on Corporate Governance**

It was discussed earlier in Chapter 3 that the corporate disclosure is an important mechanism of the corporate governance framework (Treadway, 1987; Cadbury, 1992; Green and Graham, 2005; Lin et al., 2014) and that there is a lack of research exploring corporate governance disclosure practices of listed companies in Pakistan. This research has sought to fill the gaps in literature through an in-depth empirical investigation. Furthermore, this study presents important practical implications and provides useful insights for regulators and policy makers in Pakistan (explained in detail in Chapter 7). This section analyses the first question of this research: ‘How do listed companies in Pakistan disclose corporate governance related information in annual reports?’ In order to obtain answers to this question, this section focuses on analysis of the level of voluntary and mandatory disclosures in the annual reports of listed companies from the textile, sugar and several other sectors. The level of voluntary and mandatory disclosure in all of these sectors is then compared to understand the disclosure tendency of the companies.

#### ***a. Voluntary Disclosure***

Table 5.1 shows the calculation for the level of voluntary disclosure on various corporate governance constructs across all the firms analysed.

**Table 5.1 : Level of Voluntary Disclosure across Various Corporate Governance Constructs for Years 2009–2013**

Corporate Governance Disclosures Constructs	No. of Items in Each Construct	Maximum Obtainable Score = No. of Items in Each Construct × No. of Years × No. of Firms	Actual Scores Obtained by the Firms on Various Corporate Governance Constructs					Grand Total of Actual Scores Obtained	Percentage Disclosure on Each Construct=Actual Score Obtained / Maximum Obtainable Score in Each Construct
			2009	2010	2011	2012	2013		
Textile Sector									
Accountability	4	200	27	28	27	32	35	149	75%
Independence	7	350	15	16	16	50	57	154	44%
Roles, Responsibility and Inter-relationships	13	650	55	57	59	63	62	296	46%
Profile	8	400	10	10	10	10	16	56	14%
Executive/ Director Remuneration	7	350	39	40	40	40	43	202	58%
Sugar Sector									
Accountability	4	200	31	32	32	33	23	151	76%
Independence	7	350	22	16	15	32	41	126	36%
Roles, Responsibility and Inter-relationships	13	650	64	71	70	60	70	335	52%
Profile	8	400	16	16	19	20	21	92	23%

**Table 5.1 : Level of Voluntary Disclosure across Various Corporate Governance Constructs for Years 2009–2013**

Corporate Governance Disclosures Constructs	No. of Items in Each Construct	Maximum Obtainable Score = No. of Items in Each Construct × No. of Years × No. of Firms	Actual Scores Obtained by the Firms on Various Corporate Governance Constructs					Grand Total of Actual Scores Obtained	Percentage Disclosure on Each Construct=Actual Score Obtained / Maximum Obtainable Score in Each Construct
			2009	2010	2011	2012	2013		
<b>Executive/ Director Remuneration</b>	7	350	37	41	40	38	41	197	56%
<b>Several Sectors</b>									
<b>Accountability</b>	4	400	55	56	57	55	65	288	72%
<b>Independence</b>	7	700	44	51	52	85	107	339	48%
<b>Roles, Responsibility and Inter-relationships</b>	13	1300	107	110	109	111	120	557	43%
<b>Profile</b>	8	800	31	32	39	38	42	182	23%
<b>Executive/ Director Remuneration</b>	7	700	80	78	81	85	87	411	59%

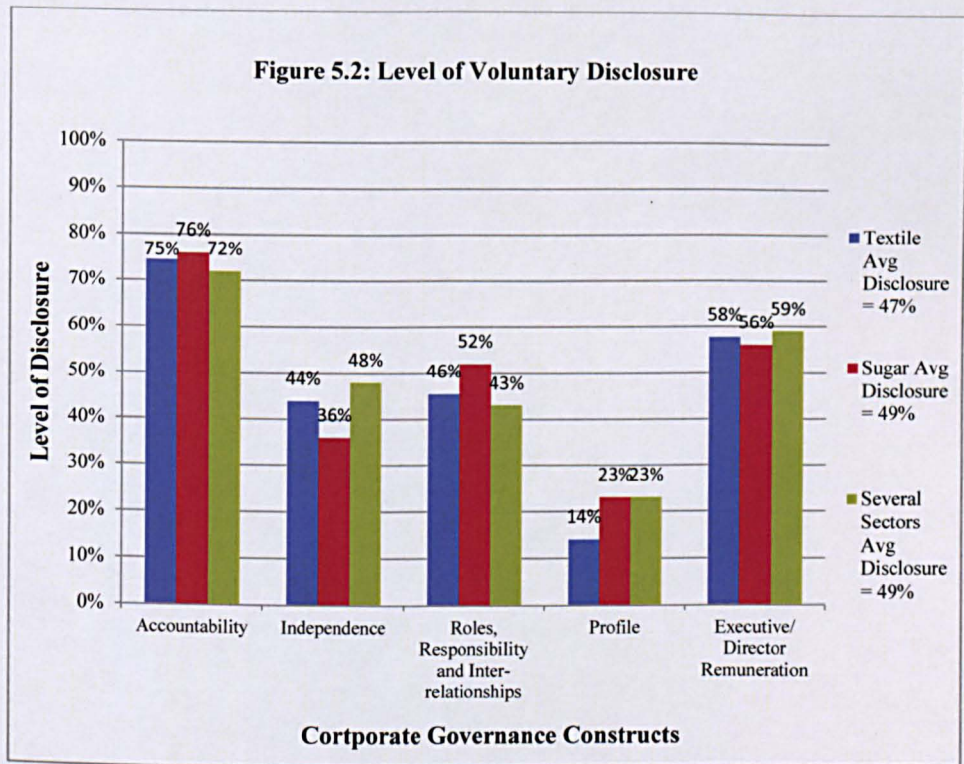
The second column of Table 5.1 shows the number of items in each corporate governance construct. Column three of the table shows the maximum obtainable score. The maximum obtainable score in a construct is calculated by multiplying the number of items in the construct with the total number of firms in each industrial sector in the sample and then by further multiplying it with the number of years under consideration. The fourth column provides the actual scores obtained across various constructs by the firms in each industrial sector from year 2009-2013. Column five provides the grand total for the actual scores obtained by firms across various corporate governance constructs over five years.

For example, in the construct of accountability, if all the (10) firms in textile sector disclosed information on all (4) items pertaining to accountability over the period of five years, then the maximum obtainable score would be  $10 \times 4 \times 5 = 200$ . However, the actual score obtained by the firms in the textile sector is 149. Therefore, the percentage of disclosure on accountability is calculated by dividing the actual score obtained (149) by the maximum obtainable score (200), that equals 75%. Similarly, the number of total firms in the ‘several sectors’ group is 20, while the maximum obtainable on the construct of accountability will be  $20 \times 4 \times 5 = 400$ .

Figure 5.2 provides a presentation by graph showing the level of disclosure in all the firms across the various corporate governance constructs (calculation provided in Table 5.1 above). It may be observed that in all of the sectors, the companies provided minimum information on the profile of the board, reflected in a 14% level of disclosure in the textile sector and a 23% level of disclosure in the sugar and ‘several sectors’ group. The level of disclosure on



executive/director remuneration was also poor; that is, 58% for the textile sector, 56 % for the sugar sector and 59% for the ‘several sectors’ group.



The findings of the qualitative content analysis in regard to voluntary disclosure on the construct of board profile support the findings of the literature reviewed in Chapter 3, Section 3.3.1. The findings of the survey conducted by International Finance Corporation (2007) had indicated that 86% of the listed companies in Pakistan did not provide biographies of the directors. The survey indicated a clear resistance in disclosure of voluntary information in the annual reports. The evidence found in Figure 5.2, reflecting a low level of disclosure on the construct of profile, shows that companies are still reluctant to share information on the skills, competencies, trainings and seminars attended, as well as the experience and biographies of the members of the board. It is important to consider that, unlike this research, the survey conducted by International Finance Corporation (2007) was merely a study of perceptions of

directors and executives of listed and non-listed companies, being that the responses of research participants were captured through questionnaires and semi-structured interviews conducted in 2007. The survey did not analyse the actual disclosure practices of listed companies. On the other hand, the current research is an investigation of the *actual* corporate governance disclosure practices of listed companies in analysing annual report data over a period of five years.

The World Bank (2005) had put forth an expectation that the formation of the Pakistan Institute of Corporate Governance would have a positive impact in improving corporate governance and disclosure environment in Pakistan. Furthermore, an increased emphasis on the part of regulatory bodies in enhancing awareness regarding corporate governance through trainings and seminars was also expected to bring significant improvements in corporate governance and disclosure environment. The World Bank (2005) had asserted that, up until 2005, companies in Pakistan had already begun to recognise the importance of corporate governance and were arranging corporate governance seminars and trainings for the members of the board. However, the findings of this research indicate that corporate governance disclosure on board profile is still limited, contrary to the expectations put forth by World Bank (2005).

It might be useful to find the explanation for this continued poor disclosure on board profile. The reasons for this poor disclosure might be sought through an analysis of Pakistan's business environment. As mentioned earlier in Chapter 2, in Pakistan's capital market, most of the firms are family-owned (Mirza and Azfa, 2010; Nawazish and Sara, 2012), and these family owners are the members of the board. Thus the appointments to the board are made on the



basis of nepotism, personal relationships and family inheritance (Afghan and Wiqar, 2007). Existing literature suggests that there is a scarcity of expert and qualified directors in family firms in South Asia in general and in Pakistan in particular (Gulzar and Wang, 2010; Hashim and Ibrahim, 2013).

Afghan and Wiqar (2007) claim that, in Pakistan, family members are included in the business regardless of their qualifications and experience. This results in the inclusion of those family members who may be incompetent and ill-qualified. According to the agency theory perspective, agency problem in organisations may arise if the agent lacks required skills and capabilities (Feldman and Montgomery, 2015). Therefore, a lack of expertise in the board of directors may prove detrimental to shareholders interests.

It might be implied from the analysis of the data that the scarcity of well-qualified members of the boards might be the reason for limited disclosure on board members' qualifications and experience. Being that these members of the board do not have relevant experience or qualification, they may avoid disclosure of it. This results in a lower level of disclosure on the construct of profile.

Figure 5.2 shows that there is a low level of disclosure on the construct of board independence; that is, 44% in the textile sector, 36% in the sugar sector and 48% in the several sectors group. It might be inferred here that family owners keep a strong control on the management of the firm. The findings of this research are consistent with Chakroun (2013), who had carried out research in the context of Tunisia, wherein it was found that firms with high levels of family control are characterised by low levels of board independence, ultimately leading to a poor level of voluntary disclosure. Various researchers

have argued that board independence is positively related to the level of voluntary corporate governance disclosure (Ben-Amar and Boujenoui, 2006; Samaha et al., 2012). It might be inferred that the number of independent directors may improve the quality of monitoring regarding corporate governance reporting and disclosure. Being that most of the businesses in Pakistan are family owned and controlled, and there is a lack of independent members on the boards, there is hence a resistance towards disclosure of this information.

Similarly, the low level of disclosure on the construct of roles, responsibility and inter-relationships of 46%, 52% and 43% in the textile, sugar and ‘several sectors’ groups respectively, might reflect that, in these firms, a clear distinction between the roles, responsibilities and inter-relationships of firm management and the board does not exist. The board members hence strongly influence firm’s management and operations. These findings are consistent with Green and Graham (2005), who found that annual reports of Canadian listed companies did not indicate a division of responsibilities between the members of the board and corporate management.

In this research, accountability received the highest score among all corporate governance constructs; that is, 75%, 76% and 72% in the textiles, sugar and several sectors groups respectively. These findings contradict the arguments presented by the World Bank (2005), who argued that the aspect of board accountability was totally absent in Pakistan’s business environment. However, the findings of this research support the findings of the Pakistan Institute of Corporate Governance (2011), who had argued that majority of the boards of directors in Pakistan feel accountable for strategic decision making in the

firms. It might thus be inferred that the boards feel answerable for their responsibility towards value creation, strategic decision making, compliance and disclosure. The analysis of silence (section 5.2) within this construct shows that most of the firms disclosed information on boards' accountability towards strategic decision making, shareholder value creation and compliance with regulation. However, only a few firms expressed their responsibility towards dissemination of information and disclosure to shareholders. These findings are consistent with those of Green and Graham (2005), who argued that most of the companies in Canada did not assume responsibility for the dissemination of corporate information to the shareholders.

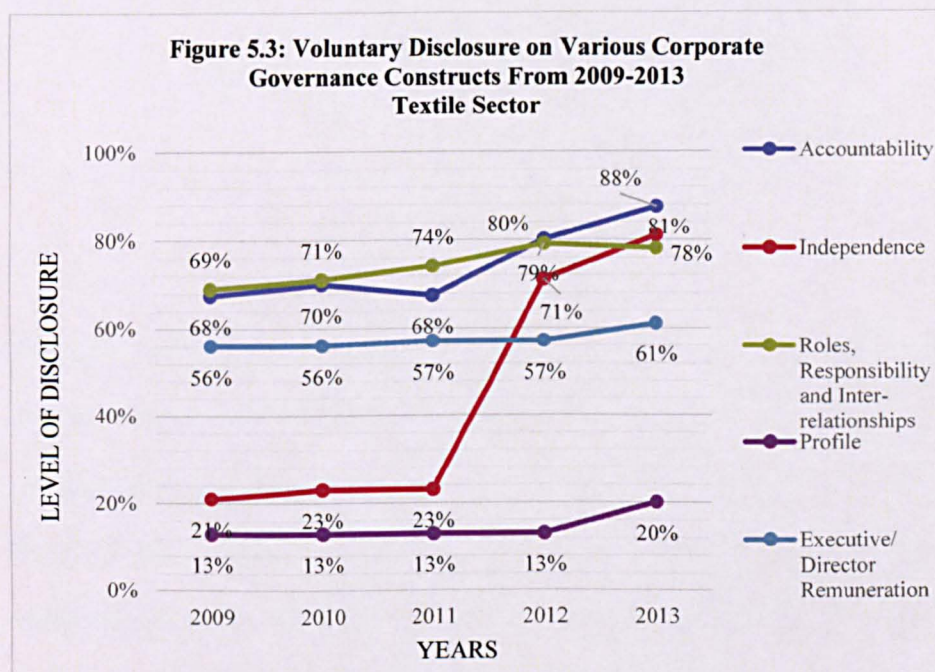
Here, it might be inferred that since these family owners have been handling these businesses for years and are well-aware that strategic decision making, profitability and compliance of regulations are central to the success of business operations. However, as strong family owners are the part of the board in such concerns, better disclosure may only benefit minority shareholders and outsiders of the firm. Therefore, they do not assume responsibility for the dissemination of information and better disclosures in the annual reports. This finding therefore supports the initial theoretical propositions that the members of the board make strategic calculations about weak minority shareholder rights and, as an expected outcome, the disclosure of information to these shareholders is not considered important. These findings are consistent with prior literature, where it was found that family control has a negative relationship with the extent of corporate governance disclosure. For example, in the context of the UK, Arcot and Bruno (2012) found that family firms often deviate from the best practices of corporate governance and disclosure.

Darmadi and Sodikin (2013) carried out research in the context of Indonesia and found that family control negatively influences corporate governance disclosure.

Figure 5.2 also shows that the average level of voluntary disclosure across corporate governance constructs in the textile sector firms is 47%, while it is 49% in both the sugar sector and the other sectors group. It might then be concluded that the average level of voluntary disclosure on various corporate governance constructs was inadequate in all the three sector groups. However, disclosure of information was better in terms of the construct of accountability, when compared to the constructs of roles, responsibilities and inter-relationships, executive/director remuneration, board independence and profile. Furthermore, it may also be observed that the practices and level of voluntary disclosure on various corporate governance constructs do not vary considerably among industries. As discussed in Chapter 3, research on the relationship between corporate governance disclosure and industry type has provided contradictory evidence. However, these findings are consistent with the findings of the existing research arguing that the level of disclosure remains unchanged across industries in developed as well as in developing countries; for example, Sweden (Andersson and Daoud, 2005) and India (Bhasin et al., 2012).

Figure 5.3 provides a presentation by graph showing the changes in the level of voluntary disclosure across corporate governance constructs from 2009 to 2013 in the textile sector. The graph shows that there is a sharp increase in the level of disclosure on the construct of independence in 2011. However, an in-depth analysis of silence revealed that the increase in the level of disclosure on

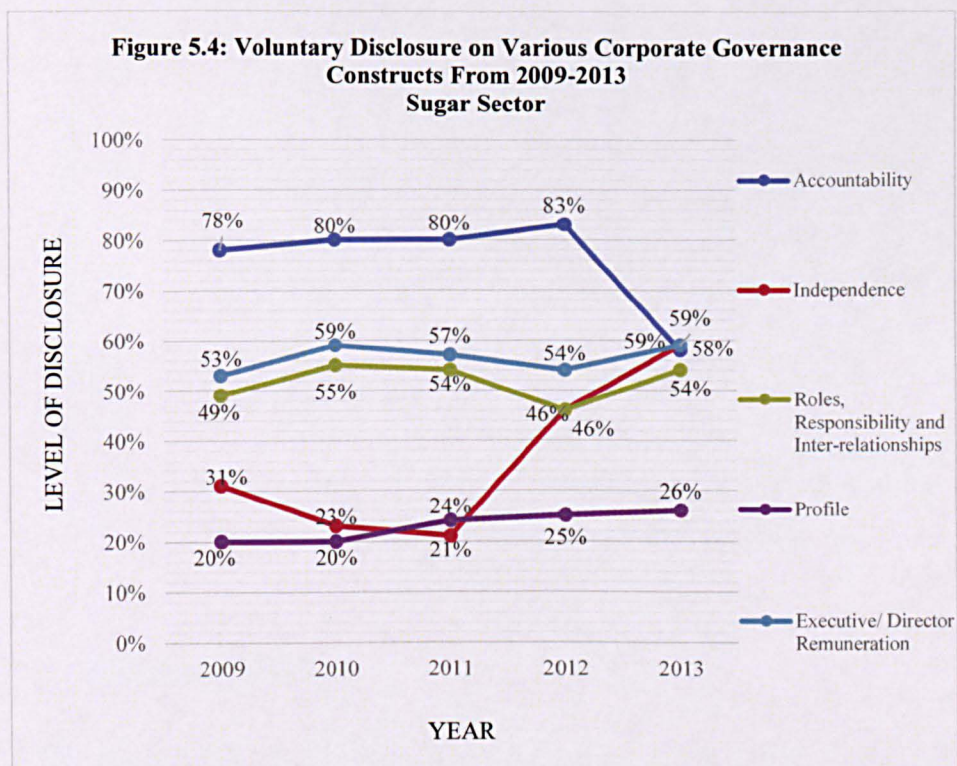
independence is actually an incidence of empty speech (refer to section 5.2.1). This construct therefore shows an improvement as companies either replaced the term ‘non-executive director’ with ‘independent’ director or started using both the terms together as ‘independent non-executive’ director. Thus the level of information provided seems to have improved over these years. The construct of accountability also showed a rising disclosure trend. However, the level of disclosure has remained similar in regard to the constructs of profile, executive/director remuneration and roles, responsibility and inter-relationships.



The graph in Figure 5.4 presents the voluntary disclosure trend in various corporate governance constructs in the sugar sector from 2009–2013. This figure also indicates a sharp upward trend in disclosure on board independence, while there is a decrease in disclosure regarding board accountability in 2012. Similar to the trend in the textile sector, the constructs of profile,

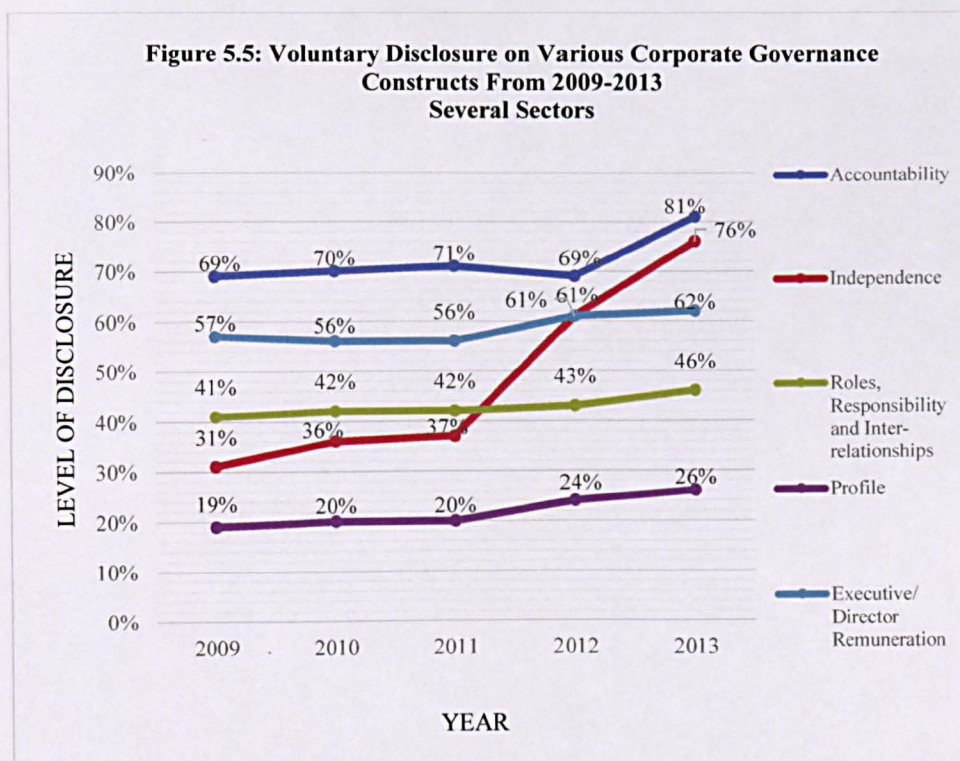


executive/director remuneration and roles, responsibility and inter-relationships remain almost constant over time.



The graph in Figure 5.5 presents the trend for the level of voluntary disclosure for the firms in the several sectors group. This trend for the disclosure on various constructs in this group is also similar to the sugar and textile sectors. There is also a rise in the level of disclosure on the construct of independence, while the constructs of accountability, profile, executive/director remuneration and roles, responsibility and inter-relationships also show a slight upward trend.





### ***b. Mandatory Disclosure***

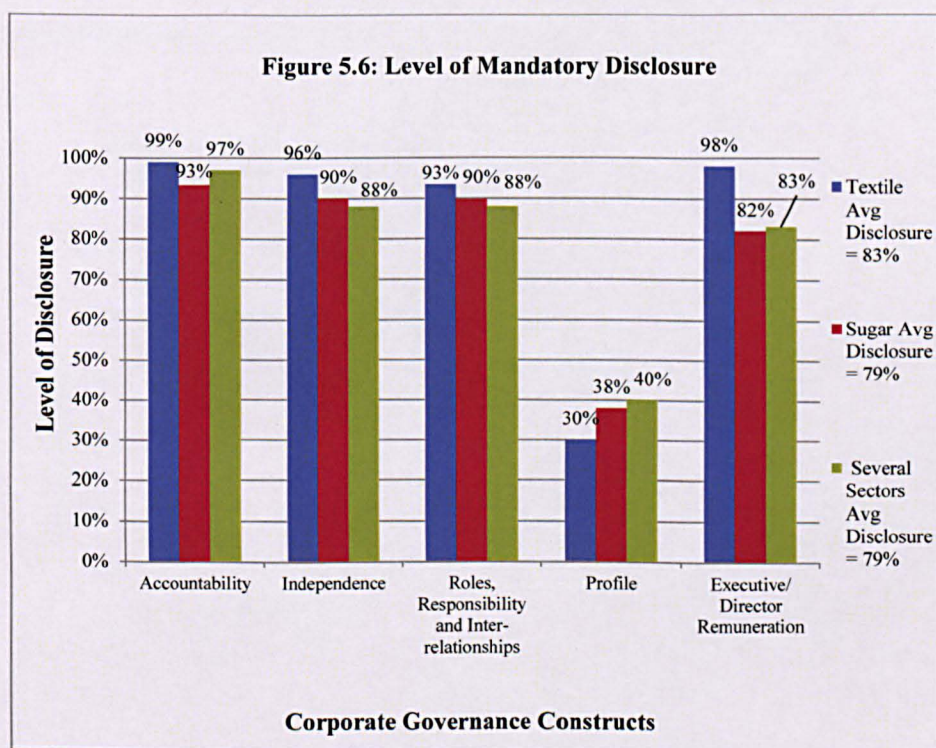
Table 5.2 provides an explanation of how the level of mandatory corporate governance disclosure in the annual reports is calculated. Table 5.2 was prepared in the same way as Table 5.1. For example, in the construct of accountability, if all the (10) firms in textile sector disclosed information on all (3) items pertaining accountability over the period of five years, the maximum obtainable score would be  $10 \times 3 \times 5 = 150$ . However, the actual score obtained by textile sector firms is 149. Therefore, the percentage of disclosure on accountability is calculated by dividing the actual score obtained (149) by the maximum obtainable score (150), that equals 99%. On the other hand, the several sectors group had 20 firms, so and maximum obtainable score for the construct of accountability would therefore be  $20 \times 3 \times 5 = 300$ .

**Table 5.2: Level of Mandatory Disclosure across Various Corporate Governance Constructs**

Table 5.2: Level of Mandatory Disclosure across Various Corporate Governance Constructs									
Corporate Governance Disclosures Constructs	No. of Items in Each Construct	Maximum Obtainable Score= No. of Items in Each Construct × No. of Years × No. of Firms	Actual Scores Obtained by the Firms on Various Corporate Governance Constructs					Grand Total of Actual Scores Obtained	Percentage Disclosure on each Construct =Actual Score Obtained/Maximum Obtainable Score in each Construct
			2009	2010	2011	2012	2013		
Textile Sector									
Accountability	3	150	29	30	30	30	30	149	99%
Independence	1	50	10	10	10	9	9	48	96%
Roles, Responsibility and Inter-relationships	20	1000	187	187	187	187	186	934	93%
Profile	1	50	1	1	4	4	5	15	30%
Executive/ Director Remuneration	1	50	10	10	10	10	9	49	98%
Sugar Sector									
Accountability	3	150	26	29	29	27	29	140	93%
Independence	1	50	8	9	10	9	9	45	90%
Roles, Responsibility and Inter-relationships	20	1000	167	180	183	185	183	898	90%
Profile	1	50	3	3	4	4	5	19	38%
Executive/ Director Remuneration	1	50	8	9	8	8	8	41	82%
Several Sectors									
Accountability	3	300	56	57	59	60	60	292	97%
Independence	1	100	16	17	17	18	20	88	88%
Roles, Responsibility and Inter-relationships	20	2000	339	346	349	357	360	1751	88%
Profile	1	100	3	3	11	12	11	40	40%
Executive/ Director Remuneration	1	100	16	14	16	18	19	83	83%



Figure 5.6 provides an overview of the level of mandatory corporate governance disclosure in the annual reports. Figure 5.6 shows that the firms in all of the sectors provide minimum information regarding the profile of the board, whereas the level of disclosure is higher for the constructs of executive/director remuneration, accountability, independence, roles, responsibility and interrelationships. The average level of disclosure on various corporate governance constructs in the textile sector is 83%, the level of disclosure in the sugar sector is 79%, while the average level of disclosure in the several sectors group is also 79%.



It is worth noticing that there is a similarity in the tendency for disclosure across each corporate governance construct in all of the industrial groups. In all of these groups, the companies provide minimum information on the construct of profile, while the level of disclosure is highest for the construct of accountability across all the sectors. The average for mandatory disclosure



across the various constructs was 79% in the sugar sector and the several sectors group, while it was 83% in the textile sector, therefore showing no difference in the pattern and level of disclosure across various constructs in these industries.

Figure 5.7 shows the trend for changes in the level of mandatory disclosure across corporate governance constructs in the textile sector from 2009 to 2013. It might be observed that the level of disclosure on all corporate governance constructs, with an exception of profile, stayed at a healthy and constant level during the time span considered. However, a noticeable improvement can be observed from 2010–2013 in the level of disclosure regarding profile.

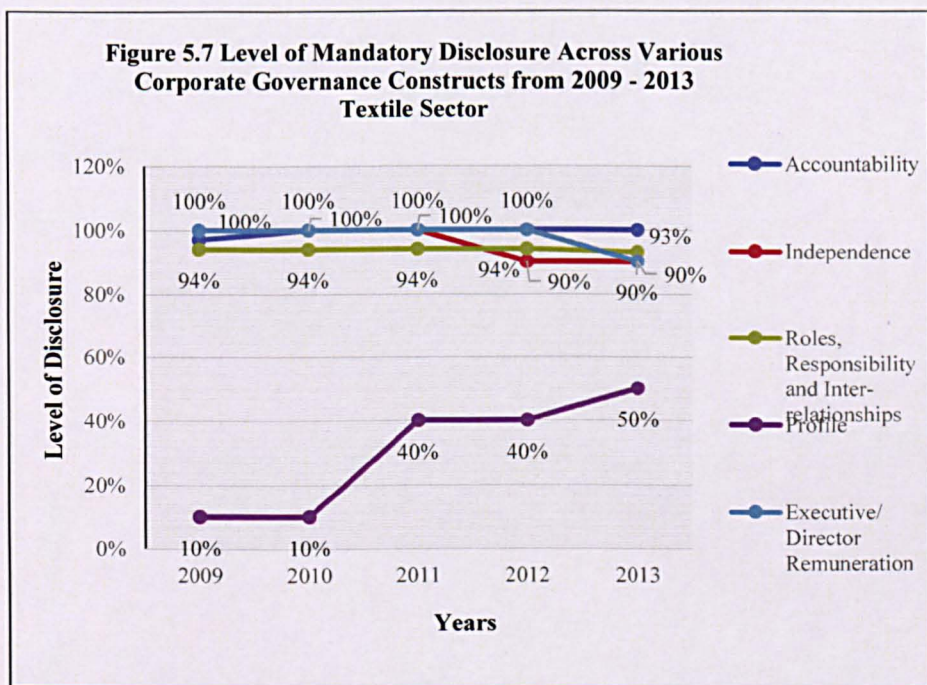
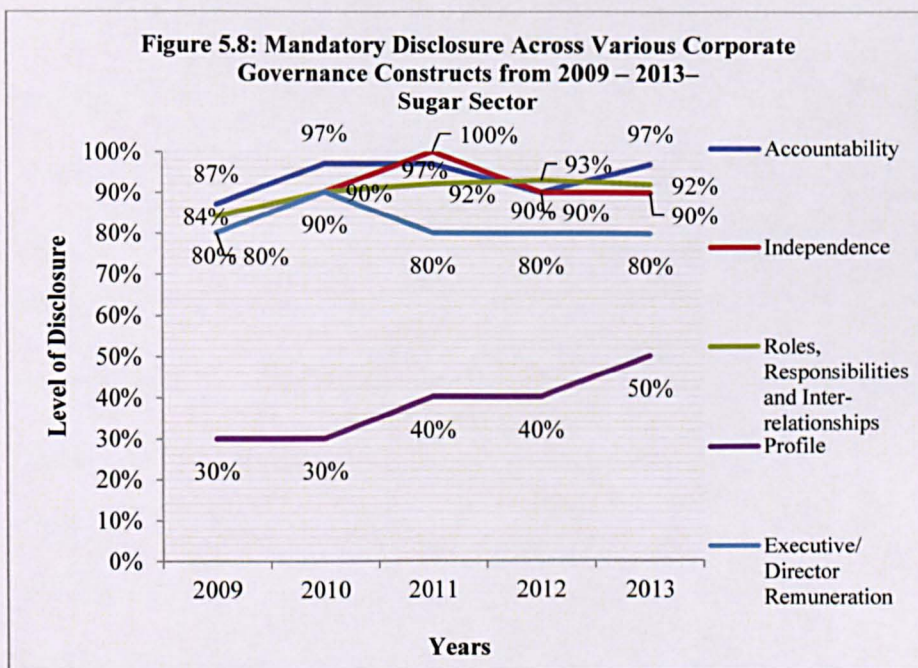


Figure 5.8 shows the trend for changes in the level of mandatory disclosure across corporate governance constructs from 2009 to 2013 in the sugar sector.





The results from the sugar sector show a similar trend to that observed in the textile sector, whereby there is a rise in disclosure on the construct of profile, while the level of disclosure of all other constructs is almost constant with a slight decline on the construct of executive/ director remuneration.

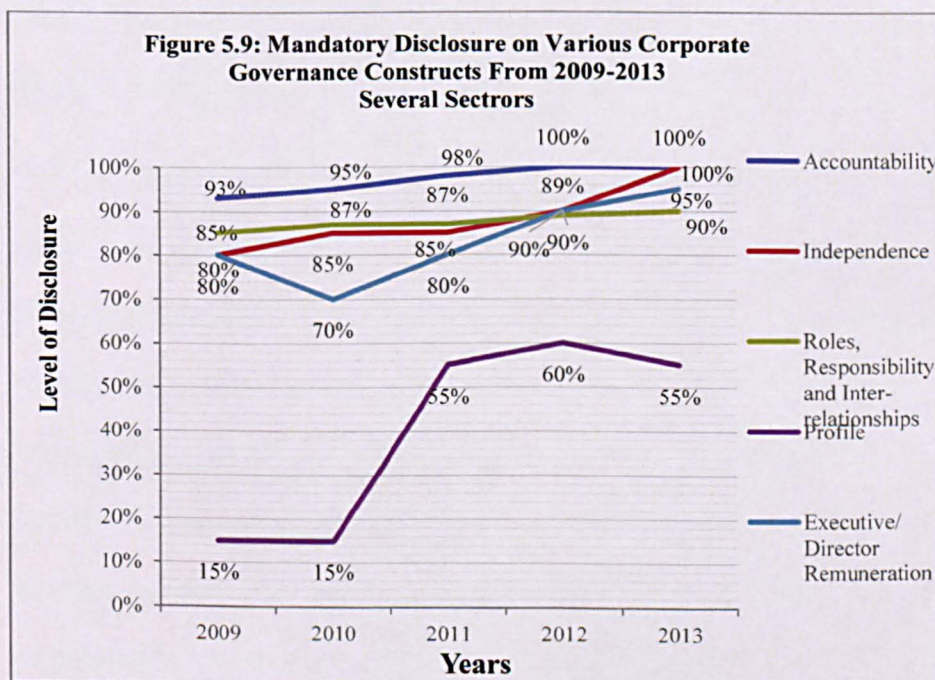


Figure 5.9 presents the trend of disclosure of various corporate governance constructs in the several sectors group. The figure shows that, in conformity with disclosure trends in the textile and sugar sectors, there is an increase in the level of disclosure on the construct of profile. It may also be observed that the level of disclosure on all other constructs also shows a steadily rising trend.

As explained in Chapter 3 Section 3.3.1, prior research on the influence of industry type on corporate governance disclosure has provided contradictory evidence. Some researchers found that industry type can have an impact upon the disclosure practices of the companies. For example, Collett and Hrasky (2005) found that, in Australia, politically visible industries<sup>26</sup> provided better disclosure, while Al-Najjar and Ding (2014) affirmed that firms in less competitive industries provide better disclosure in the context of UK. However, some researchers did not find any relationship between industry type and corporate disclosure (Andersson and Daoud, 2005; Bhasin, 2012). Hence, the results obtained in this research reinforce the notion that there is no variation in the level of corporate governance disclosure across the industries analysed.

### *c) A Comparison Between Voluntary and Mandatory Disclosure*

Green and Graham (2005) studied the relationship between corporate governance regulation and corporate governance disclosure in the context of Canada. They found that companies in Canada avoided strict regulation but were willing to provide information about their corporate governance practices voluntarily. Green and Graham (2005) concluded that since companies had developed a culture for voluntary disclosure, there was no need for introduction of mandatory corporate governance disclosure requirements in the context of

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<sup>26</sup> Collett and Hrasky (2005) classified resource industries, metals, oil and gas and diversified resources as politically visible industries.



Canada. In order to investigate the tendency towards corporate governance disclosure in the listed companies of Pakistan, a comparison has hence been carried out between the level of voluntary and mandatory corporate governance disclosure in annual reports.

Figure 5.10 below provides a comparison between the level of voluntary and mandatory disclosure on various corporate governance constructs in the textile sector. It shows that the mean for voluntary disclosure across all the constructs is 47 %, while that for mandatory disclosures is 83%. The difference between the two means is 36% which shows a large discrepancy.

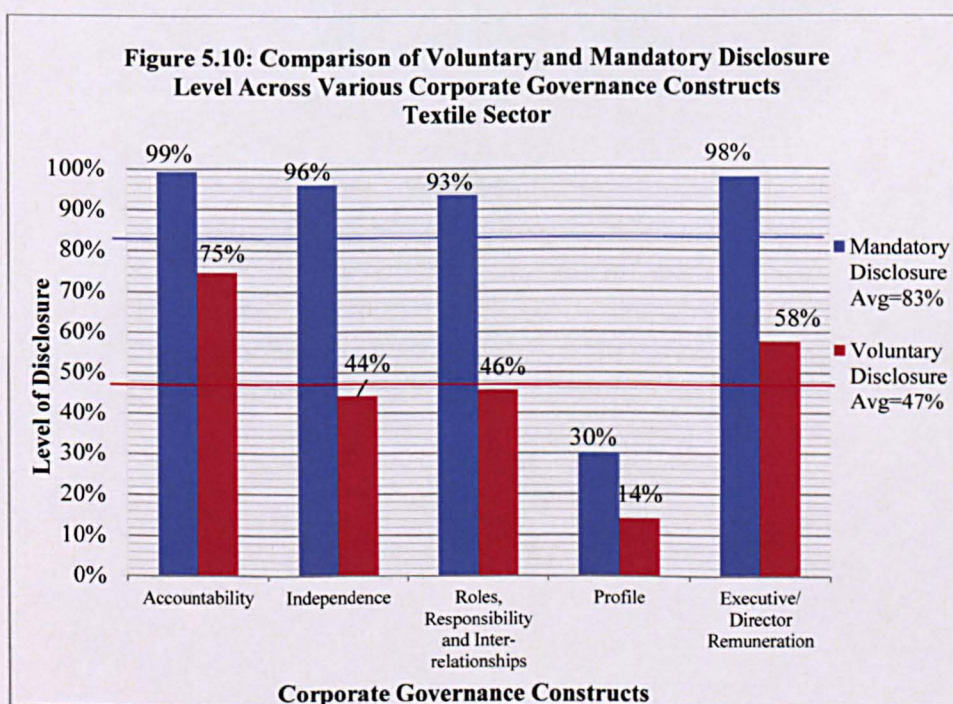


Figure 5.11 shows a comparison between the level of voluntary and mandatory disclosure on the various corporate governance constructs in the sugar sector. It shows that the mean for voluntary disclosure across all the constructs is 48 %, while that for mandatory disclosure it is 79%. The difference between the two means is 31% which again shows a large discrepancy. The reason for this margin might be the fact that most of the firms disclose mandatory information



to comply with legal requirements. The voluntary disclosure of information does, however, not seem to be a priority for them.

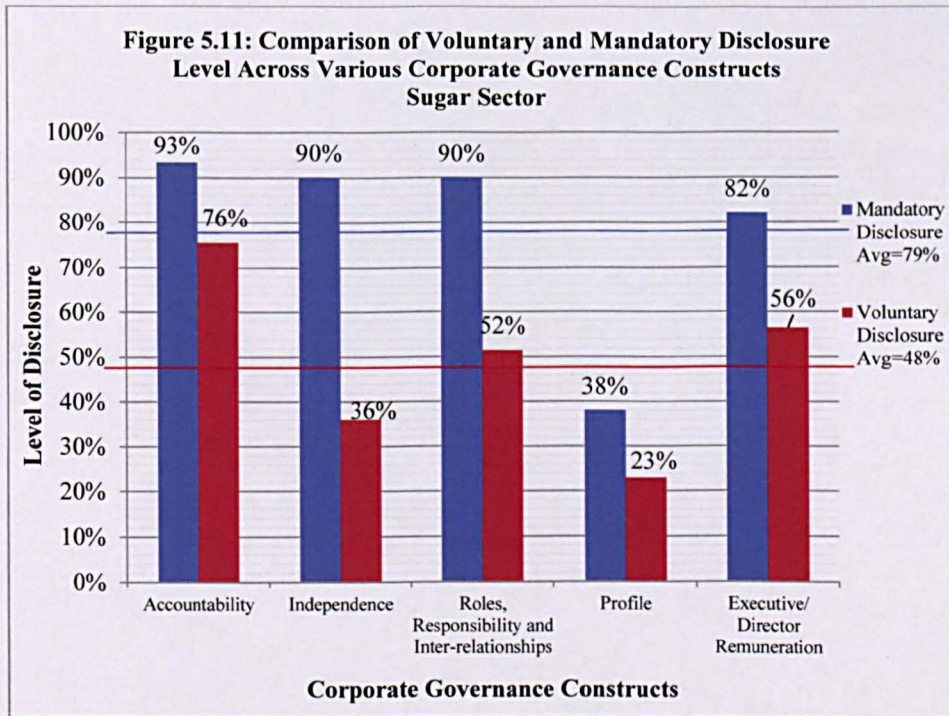
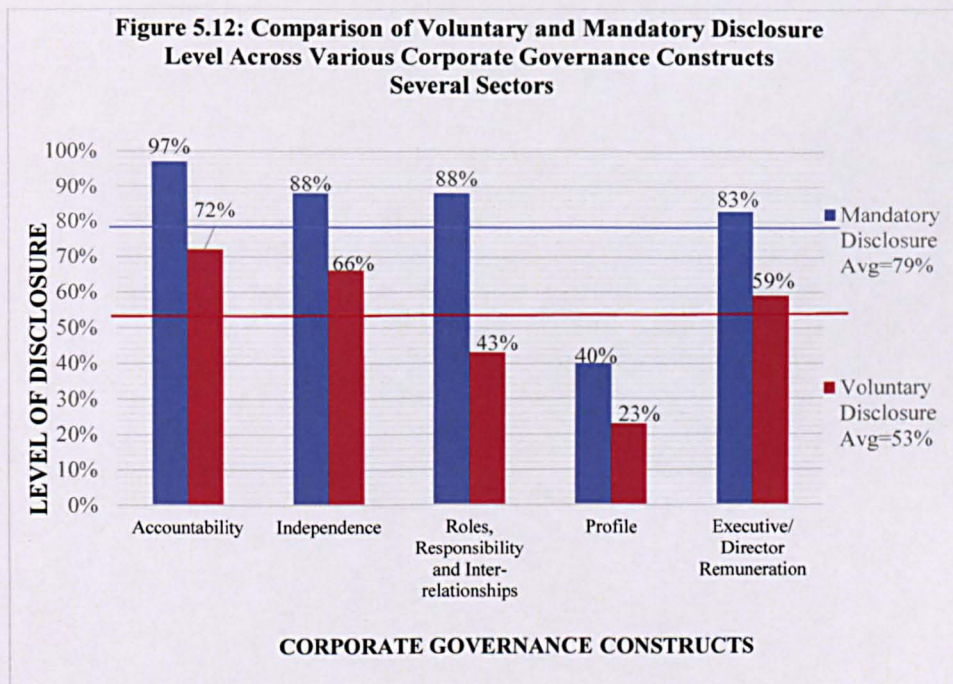


Figure 5.12 presents a comparison between voluntary and mandatory disclosure across various corporate governance constructs in the several sectors group.





It might be observed that there is also a large discrepancy between the level of voluntary and mandatory disclosure across various corporate governance constructs in the several sectors group: the difference between average mandatory and voluntary disclosure is 26% (79%-53%). These findings indicate that companies in Pakistan are not willing to disclose corporate governance information voluntarily. Instead, there is a need for strict regulation to ensure the disclosure of corporate information. These findings contradict those of Green and Graham (2005), who had found that a culture of disclosure was developing in Canada and that there was hence no need for the introduction of mandatory corporate governance regulation.

These findings support the initially developed research propositions, whereby corporate governance regulation serves to minimise agency problem and information asymmetry between family members and minority shareholders, while the level of mandatory information disclosure remains high. However,

the low level of voluntary disclosure shows reluctance on the part of companies' management towards information sharing.

These findings also support the findings of Sharma (2014). Sharma (2014) had found that the level of mandatory disclosure in the companies in Nepal was 91%, while the level of voluntary disclosure was only 48%. The findings of Sharma (2014) might also be considered relevant for this research as Nepal is also a South Asian developing country and most of the listed companies in Nepal's capital market are also family owned and controlled. Hence the findings of this research suggest a potential general pattern that could be investigated in other countries that have a similar capital market structure and context to Pakistan and Nepal.

Table 5.3 provides a comparison between average disclosure level across various constructs in the sugar, textile and the other sectors group. It also shows that there is minimal variation between the levels of mandatory disclosure in these industries. In fact, there is a difference of only 4%; that is, 83% in the textile sector and 79% in the sugar sector and the other sectors group. The variation in the average level of voluntary disclosure is also very small across the different sectors; that is, 47% in the textile sector, 48% in sugar sector and 53% in the other sectors group. Moreover, the level of mandatory disclosure is considerably higher than voluntary disclosure in all of the industries.



<b>Table 5.3: Average Disclosure across Various Corporate Governance Constructs Sugar, Textile and Other Sectors</b>		
	<b>Average Mandatory Disclosure</b>	<b>Average Voluntary Disclosure</b>
<b>Textile Sector</b>	83%	47%
<b>Sugar Sector</b>	79%	48%
<b>Other Sectors</b>	79%	53%

It can be concluded from the above analysis that the average level of mandatory disclosure is evidently higher than the level of voluntary disclosure. Being that this research has compared the annual report data between the sugar sector, textile sector and the several sectors group, it may also be inferred that the level of disclosure does not change very much across industries. As discussed in Chapter 3, prior research into the impact of industry type on corporate governance research has found contradictory results, whereby several researchers found that the level of corporate governance disclosure varies across different industries (Toms et al., 2007; Muhamad et al., 2009; An et al., 2011). However, this research supports the findings from studies by Andersson and Daoud (2005) and Bhasin (2012) where no relationship was found between industry type and level of disclosure. It might also be considered that this research compares the disclosure practices of 40 small and medium size firms. A study involving a larger number of firms might therefore provide further confirmation of these results.

The findings of this research are in accordance with the theoretical propositions set out at the beginning of the project. As proposed by agency theory and rational choice institutionalism, the members of the board are self-interested and opportunistic and extract benefits from information asymmetry. However,

they make strategic calculations about the institutional environment and thus make rational decisions. The results of the study indicate that the members of the board are self-interested and opportunistic and therefore avoid providing information voluntarily, as can be observed in the low level of voluntary disclosure. However, they make calculations about the strict regulatory environment of the country and make a rational decision to disclose a good level of mandatory information (further evidence in support of this claim was found during the analysis of interview data and is provided in detail in Chapter 6).

### **5.1.2 Level of Mandatory Disclosure across Politically Connected and Non-Connected Firms**

This section aims to answer the second sub-question of this research; that is, ‘How does political connectedness influence the disclosure of mandatory corporate governance information in the annual reports of listed companies in Pakistan?’

Disclosure scores have been calculated across politically connected and non-connected firms. In order to enhance the rigour and robustness of the research results, disclosure scores were calculated separately across politically connected and non-connected firms. On the basis of these scores, the percentage of disclosure level was thus calculated for each firm in these sectors. Table 5.4 provides the scores obtained on the mandatory disclosure coding sheet in the sugar and textile sectors.

Table 5.4: Mandatory Disclosure Across Politically Connected and Non-Connected Firms- Sugar and Textile Sectors

Status of Political Connectedness	Firms (Names Anonymised)	Maximum Obtainable Score = No. of Items in the Mandatory Disclosure Index × No of Years	Actual Score Obtained by the Firms					Grand Total	Average %age Disclosure= Actual Score/Maximum Obtainable Score
			2009	2010	2011	2012	2013		
Politically Connected	T1	130	24	24	24	24	23	119	92%
	T2	130	24	24	24	24	23	119	92%
	T3	130	23	23	23	22	22	113	87%
	T4	130	22	22	22	22	22	110	85%
	T5	130	24	24	24	22	23	117	90%
	S1	130	25	25	24	20	23	117	90%
	S2	130	17	20	20	20	21	98	75%
	S3	130	1	20	24	24	23	92	71%
	S4	130	23	21	21	24	22	111	85%
	S5	130	23	23	23	22	23	114	88%
Non-Connected	T6	130	24	25	25	25	25	124	95%
	T7	130	24	24	25	25	24	122	94%
	T8	130	24	24	25	26	25	124	95%
	T9	130	24	24	24	24	26	122	94%
	T10	130	24	24	25	26	26	125	96%
	S6	130	23	23	24	25	24	119	92%
	S7	130	25	26	26	24	24	125	96%
	S8	130	25	25	24	25	25	124	95%
	S9	130	25	24	24	24	24	121	93%
	S10	130	25	23	24	25	25	122	94%

\* Average disclosure in connected firms= 85%. Average disclosure in Non-connected firms= 94%

Table 5.4 shows the scores obtained by the firms from 2009 to 2013 in the sugar and textile sectors. The maximum obtainable score is the maximum score a firm can obtain if it provides disclosure on all disclosure items across all five years. It is calculated by multiplying the number of items in the mandatory disclosure index (26) by the number of years (5), which equals 130. The grand total is the sum of the actual score obtained by each firm from 2009–2013. The average percentage disclosure in the last column of Table 5.4 is calculated by dividing the actual score obtained by each firm by the maximum obtainable score. For example, T1 obtained a score of 119. Its average percentage disclosure is calculated as  $119/130 \times 100$  which is equal to 92%.

Table 5.4 shows that the average level of disclosure in connected firms is 85%, while for non-connected firms it is 9% higher at 94%.

In order to strengthen the results of this earlier analysis, level of mandatory disclosure across politically connected and non-connected firms was carried out in other sectors group. The results of this analysis are provided in table 5.5.

<b>Table 5.5: Mandatory Disclosure across Politically Connected and Non-Connected Firms in the Several Sectors Group</b>									
<b>Status of Political Connectedness</b>	<b>Firm Name</b>	<b>Maximum Obtainable Score = No. of Items in the Mandatory Disclosure Index × No of Years</b>	<b>Actual Score Obtained by the Firms</b>					<b>Grand Total</b>	<b>Average %age Disclosure= Actual Score/Maximum Obtainable Score</b>
			<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>		
<b>Politically Connected</b>	<b>SS1</b>	130	20	21	21	22	23	107	82%
	<b>SS2</b>	130	19	20	21	22	23	105	81%
	<b>SS3</b>	130	19	19	19	19	20	96	74%
	<b>SS4</b>	130	22	22	23	24	24	115	88%
	<b>SS5</b>	130	21	20	24	22	22	109	84%
	<b>SS6</b>	130	19	19	19	19	21	97	75%
	<b>SS7</b>	130	25	25	25	24	22	121	93%
	<b>SS8</b>	130	22	25	23	26	24	120	92%
	<b>SS9</b>	130	19	19	22	24	24	108	83%
	<b>SS10</b>	130	20	22	20	20	20	102	78%
<b>Non-Connected</b>	<b>SS11</b>	130	23	23	23	26	24	119	92%
	<b>SS12</b>	130	20	21	21	26	26	114	88%
	<b>SS13</b>	130	24	24	25	25	25	123	95%
	<b>SS14</b>	130	22	22	22	22	22	110	85%
	<b>SS15</b>	130	21	22	21	21	22	107	82%
	<b>SS16</b>	130	22	22	24	26	25	119	92%
	<b>SS17</b>	130	25	23	25	26	26	125	96%
	<b>SS18</b>	130	23	24	25	24	25	121	93%
	<b>SS19</b>	130	21	21	24	22	23	111	85%
	<b>SS20</b>	130	23	23	25	25	29	125	96%

\* Average disclosure in connected firms= 83%. Average disclosure in Non-connected firms= 90%

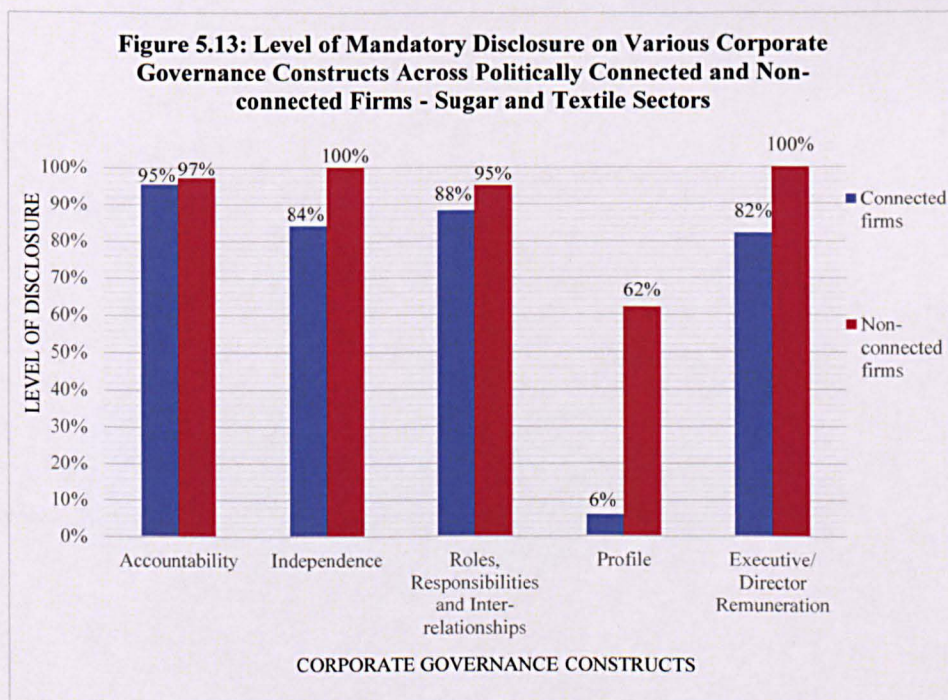
Table 5.5 shows the scores obtained by all the firms from 2009 to 2013 in the annual reports of the firms in the several sectors group. Table 5.5 was prepared in the same way as Table 5.4. The maximum obtainable score is the maximum score a firm can obtain if it provides disclosure on all the disclosure items over all five years. It is calculated by multiplying the number of items in the mandatory disclosure index (26) by the number of years (5) and equals 130. The grand total is the sum of the actual score obtained by each firm from 2009–2013. The average percentage disclosure in the last column of Table 5.5 is calculated by dividing the actual score obtained by each firm by the maximum obtainable score. For example, SS1 obtained a score of 107. Its average percentage disclosure is calculated as  $107/130 \times 100$  which is equal to 82%.

Table 5.5 shows that the average level of disclosure in connected firms is 83%, while for non-connected firms it is 7% higher at 90%. These results strengthen the findings of the earlier analysis, whereby the level of mandatory disclosure in the firms from the sugar and textile sectors was lower in politically connected firms in comparison with non-connected firms (85% and 94% respectively). In order to understand in depth the disclosure practices of politically connected and non-connected firms, a detailed analysis was carried out, whereby the level of disclosure across each corporate governance construct was calculated for comparison purposes. The results of the analysis are presented in the following sections.

**a. Mandatory Disclosure across Corporate Governance Constructs**

• ***Sugar and Textile Sectors***

Figure 5.13 provides a presentation by graph, showing the level of mandatory disclosure across corporate governance constructs in politically connected and non-connected firms.



It is evident from Figure 5.13 that, except for the construct of accountability, politically connected firms display lower levels of disclosure in comparison with non-connected firms. The construct of profile shows the highest variation, where the disclosure level in the non-connected firms is 62%, while in the connected firms it is only 6%. This amounts to a margin of 56%. This margin is 16% in the case of independence, 7% for roles, responsibility and inter-relationships and 18% for executive/director remuneration.

**Table 5.6: Mandatory Disclosure on Various Corporate Governance Constructs across Politically Connected and Non-Connected Firms – Textile and Sugar Sectors**

Corporate Governance Constructs	No. of Items in Each Construct	Maximum Obtainable Score by All Connected Firms=No. Of Items in Each construct × No. of Years × No. of Connected Firms	Actual Score By Connected Firms	Level of Disclosure in Connected Firms	Maximum Obtainable Score by All Non-Connected Firms=No. Of Items in Each construct × No. of Years × No. of Non-Connected Firms	Actual Score Obtained by All Non-Connected Firms	Level of Disclosure in Non-Connected Firms
Accountability	3	150	143	95%	150	146	97%
Independence	1	50	42	84%	50	50	100%
Roles, Responsibility and Inter-relationships	20	1000	881	88%	1000	951	95%
Profile	1	50	3	6%	50	31	62%
Executive/ Director Remuneration	1	50	41	82%	50	50	100%



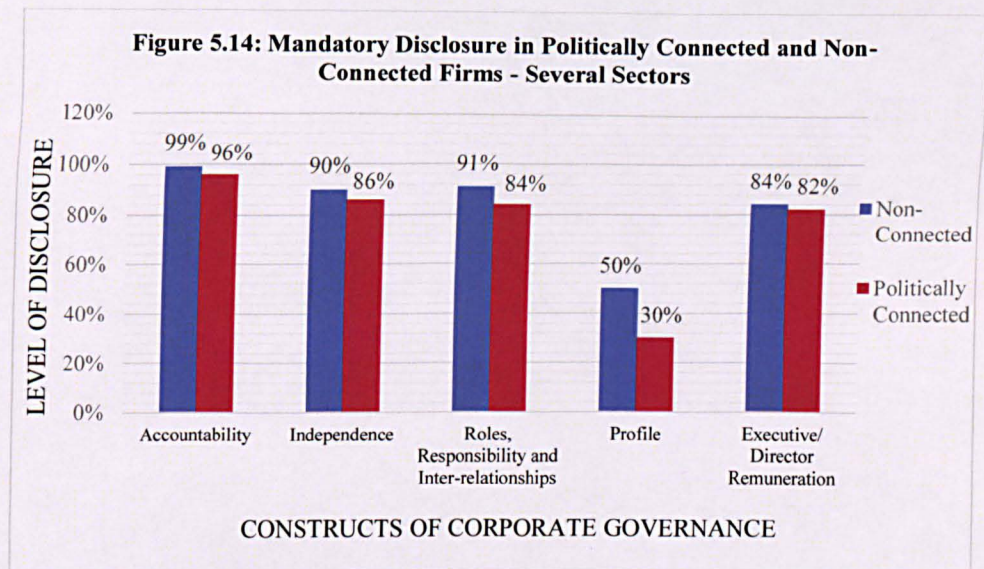
Table 5.6 provides the information on the calculation of the level of mandatory disclosure across politically connected and non-connected firms in the sugar and textile sectors. The second column of the table provides the number of items in each construct. The third column provides the maximum obtainable score across all connected firms. This is obtained by multiplying the number of items in each construct by the number of years (5) and then by further multiplying it by the number of politically connected firms (10). For example, in the construct of accountability the number of items is three. Thus the maximum obtainable score is calculated as  $3 \times 5 \times 10 = 150$ .

Column four provides the actual score obtained by connected firms, which is 143 in the construct of Accountability. In column five, the level of disclosure for connected firms is calculated by dividing the actual score obtained by the maximum obtainable score. Thus, the level of disclosure for accountability in politically connected firms is calculated as  $143/150 \times 100$ , which is equal to 95%. This disclosure for non-connected firms is calculated in a similar way in the other columns of the table.

- *Several Sectors*

Figure 5.14 provides a comparison of mandatory disclosure across politically connected and non-connected firm in the several sectors group. It might be observed that, as was observed in earlier analysis of mandatory disclosure in the sugar and textile sectors, politically connected firms are disclosing lower level of information on all the constructs of corporate governance. In conformity with the results from the sugar and textile sectors, the construct of profile shows the highest variation where the disclosure level in connected firms is 50%, while in the non-connected firms it is 30%, amounting to a

margin of 20%. This margin is then 4% in the case of independence, 7% for roles, responsibility and inter-relationships and 2% for executive/director remuneration.



The results of this analysis reveal that the level of disclosure on the profile of the board is considerably less in politically connected firms. In the construct of profile, the requirement for attending corporate governance trainings is mandatory and the Securities and Exchange Commission of Pakistan can impose penalties in the case of non-compliance. However, disclosure regarding this construct is poor in the annual reports of politically connected firms. In other words, these firms face the risk of being penalised (a monetary threat) but do not attend training; nor do they explain the reasons for non-compliance.

**Table 5.7: Mandatory Disclosure on Various Corporate Governance Constructs across Politically Connected and Non-Connected Firms – Several Sectors**

<b>Corporate Governance Constructs</b>	<b>No. of Items in Each Construct</b>	<b>Maximum Obtainable Score by All Connected Firms=No. Of Items in Each construct x No. of Years x No. of Connected Firms</b>	<b>Actual Score By Connected Firms</b>	<b>Level of Disclosure in Connected Firms</b>	<b>Maximum Obtainable Score by All Non-Connected Firms=No. Of Items in Each construct x No. of Years x No. of Non-Connected Firms</b>	<b>Actual Score Obtained by All Non-Connected Firms</b>	<b>Level of Disclosure in Non-Connected Firms</b>
<b>Accountability</b>	3	150	144	96%	150	148	99%
<b>Independence</b>	1	50	43	86%	50	45	90%
<b>Roles, Responsibility and Inter-relationships</b>	20	1000	839	84%	1000	912	91%
<b>Profile</b>	1	50	15	30%	50	25	50%
<b>Executive/ Director Remuneration</b>	1	50	41	82%	50	42	84%

Table 5.7 provides information on the calculation of the level of mandatory disclosure across politically connected and non-connected firms in the several sectors group. The second column of the table provides the number of items in each construct. The third column provides the maximum obtainable score across all connected firms, one obtained by multiplying the number of items in each construct by the number of years (5) and then by further multiplying it by the number of politically connected firms (10). For example, in the construct of accountability the number of items is three. Thus the maximum obtainable score is calculated as  $3 \times 5 \times 10 = 150$ .

Column four provides the actual score obtained by connected firms, which is 144 in the construct of Accountability. In column five, the level of disclosure for connected firms is calculated by dividing the actual score obtained by the maximum obtainable score. Thus, the level of disclosure for accountability in politically connected firms is calculated as  $144/150 \times 100$ , which is equal to 96%. This disclosure for non-connected firms is calculated in a similar way for the other columns of the table.

***b. Trend of Increase/Decrease in the Level of Mandatory Disclosure from 2009–2013***

In order to obtain a deeper understanding of the differences in mandatory disclosure level between politically connected and non-connected firms, the trend of increase/decrease in the level of disclosure was observed across the period under analysis. Figure 5.15 shows the results of that analysis for the sugar and textile sectors.



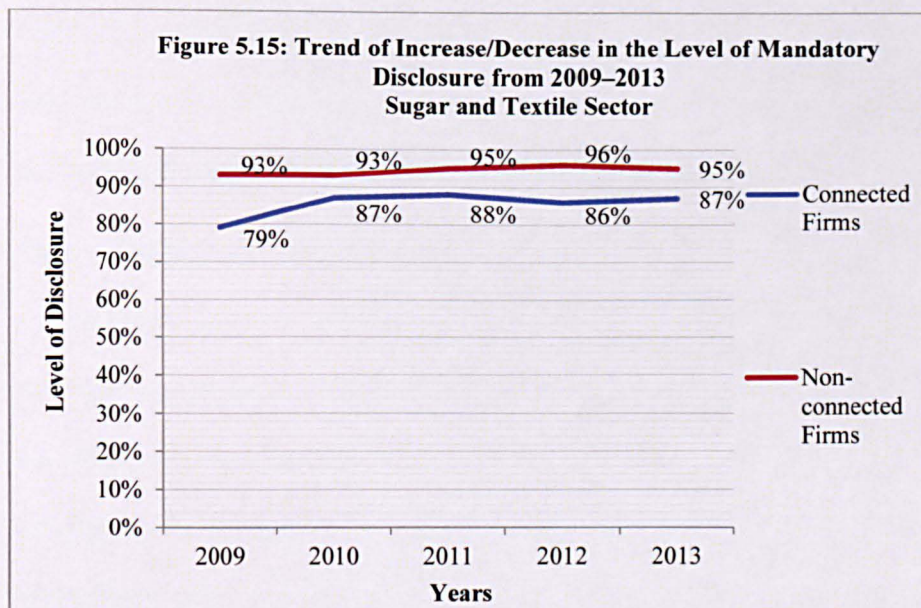


Figure 5.15 shows a higher level of disclosure in non-connected firms for each year, in comparison with connected firms. In addition, in 2009 the level of mandatory disclosure in connected firms was 79%. That level of disclosure increased over time and in 2013, the level of disclosure was 87%. On the other hand, the level of disclosure in non-connected firms remained almost constant over the years.

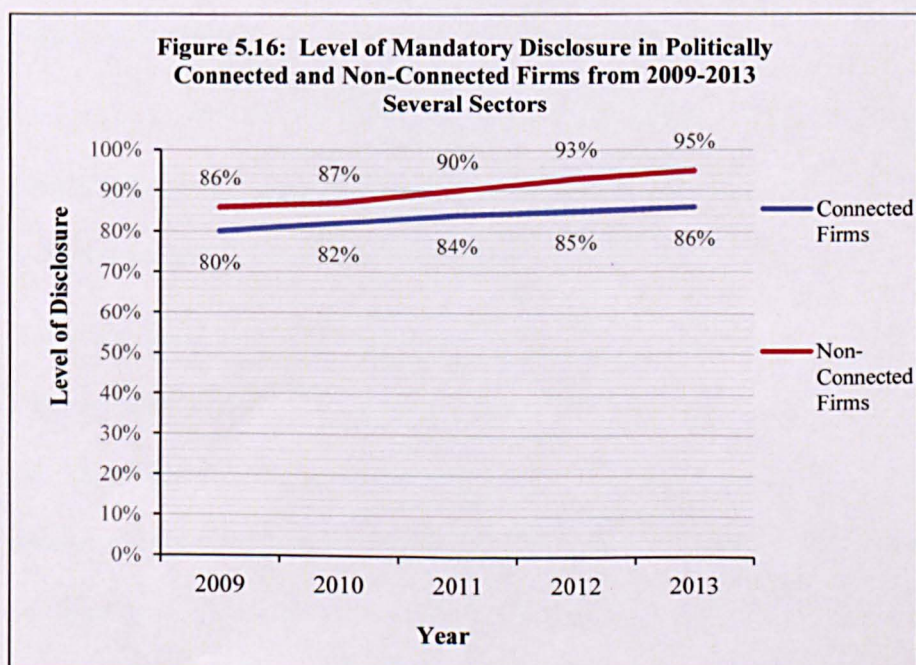


Figure 5.16 validates the trend observed in Figure 5.15 above. It might be observed that, for each year, the level of disclosure in non-connected firms was also higher in comparison with connected firms in several sectors group.

These findings are consistent with the findings of prior research on the reporting and disclosure practices of politically connected firms. In the context of China, for example, Piotroski et al. (2015), Huang et al. (2014) and Stuart and Wang (2014) found that connected firms manipulate and restrict the flow of corporate information. These findings also support the initially developed propositions of the research that suggested that politically connected members of the board have utility maximising preferences. Hence, in order to satisfy their self-interests they opt for such actions that are not favourable for (minority) shareholders. In order to hide their politically motivated, rent-seeking activities, they hence constrain dissemination of information to shareholders, leading to a poor level of corporate governance disclosure.

### **5.1.3 Level of Voluntary Disclosure across Politically Connected and Non-Connected Firms**

This section answers the third question of this research, ‘How does political connectedness influence the disclosure of voluntary corporate governance information in the annual reports of listed companies in Pakistan?’

Table 5.8 shows the voluntary disclosure scores obtained by all the firms from 2009 to 2013 in the textile and sugar sectors. The maximum obtainable score is the maximum score that a firm can obtain if it provides disclosure on all disclosure items over all five years. It is calculated by multiplying the number of items in the voluntary disclosure index (39) by the number of years (5), which equals 195. The grand total is the total for the actual scores obtained by

individual firms. The average percentage disclosure is calculated by dividing the actual score obtained by each firm by the maximum obtainable score. For example, T1 obtained a voluntary disclosure score of 67. Its average percentage disclosure is calculated as  $67/195 \times 100 = 34\%$

**Table 5.8: Voluntary Disclosure across Politically Connected and Non-Connected Firms – Textile and Sugar**

Status of Political Connectedness	Firm Name (Anonymised)	Maximum Obtainable Score = No. of Items in the Voluntary Disclosure Index × No of Years	Actual Score Obtained by the Firms					Grand Total	Average %age Disclosure = Actual Score/Maximum Obtainable Score
			2009	2010	2011	2012	2013		
Politically Connected	T1	195	12	12	12	15	16	67	34%
	T2	195	13	13	13	17	18	74	38%
	T3	195	11	12	13	16	20	72	37%
	T4	195	14	14	14	16	21	79	41%
	T5	195	13	13	13	18	18	75	38%
	S1	195	15	16	14	16	15	76	39%
	S2	195	16	17	18	17	18	86	44%
	S3	195	9	9	9	9	19	55	28%
	S4	195	16	13	12	14	8	63	32%
	S5	195	17	19	19	17	20	92	47%
Non-Connected	T6	195	19	19	20	25	29	112	57%
	T7	195	17	17	16	22	25	97	50%
	T8	195	16	16	17	22	22	93	48%
	T9	195	15	19	18	23	20	95	49%
	T10	195	16	16	16	21	24	93	48%
	S6	195	18	19	19	23	25	104	53%
	S7	195	19	21	21	18	18	97	50%
	S8	195	15	17	16	18	22	88	45%
	S9	195	24	24	23	25	26	122	63%
	S10	195	21	21	25	26	25	118	61%

\* Average disclosure in connected firms = 38%. Average disclosure in non-connected firms = 52%



Table 5.8 shows that the average level of voluntary disclosure in politically connected firms is 38%, while that in non-connected firms is 52 %. Therefore, politically-connected firms disclose 14% less information than non-connected firms in the textile and sugar sectors.

Table 5.9 presents the voluntary disclosure scores obtained by all the firms in the several sectors group. Scores in the table are calculated in the same way as they were calculated in Table 5.8. The maximum obtainable score is the maximum score that a firm can obtain if it provides disclosure on all disclosure items over all five years. It is calculated by multiplying the number of items in the voluntary disclosure index (39) by the number of years (5) to produce a total of 195. The grand total is therefore the total for the actual scores obtained by individual firms. The average percentage disclosure is calculated by dividing the actual score obtained by each firm by the maximum obtainable score. For example, SS1 obtained a voluntary disclosure score of 77. Its average percentage disclosure is calculated as  $77/195 \times 100 = 39\%$ .

**Table 5.9: Voluntary Disclosure across Politically Connected and Non-Connected Firms – Several Sectors**

Status of Political Connectedness	Firm Name	Maximum Obtainable Score = No. of Items in the Voluntary Disclosure Index × No of Years	Actual Score Obtained by the Firms					Grand Total	Average %age Disclosure= Actual Score/Maximum Obtainable Score
			2009	2010	2011	2012	2013		
Politically Connected	SS1	195	15	15	14	14	19	77	39%
	SS2	195	13	13	13	12	15	66	34%
	SS3	195	11	8	11	10	17	57	29%
	SS4	195	15	15	16	16	19	81	42%
	SS5	195	16	16	16	18	19	85	44%
	SS6	195	15	17	19	18	21	90	46%
	SS7	195	14	14	14	18	18	78	40%
	SS8	195	18	20	15	14	25	92	47%
	SS9	195	12	13	10	17	16	68	35%
	SS10	195	15	20	15	15	20	85	44%
Non-Connected	SS11	195	18	18	18	21	22	97	50%
	SS12	195	15	15	15	17	21	83	43%
	SS13	195	17	17	21	21	22	98	50%
	SS14	195	17	19	21	25	25	107	55%
	SS15	195	13	13	15	16	18	75	38%
	SS16	195	24	25	27	32	32	140	72%
	SS17	195	19	19	27	30	31	126	65%
	SS18	195	20	20	20	23	23	106	54%
	SS19	195	23	23	23	27	27	123	63%
	SS20	195	33	33	33	33	33	165	85%

\* Average disclosure in connected firms = 40%. Average disclosure in non-connected firms = 57%

Table 5.9 shows that the average level of voluntary disclosure in politically connected firms is 40%, while for non-connected firms it is 57%. Therefore, politically-connected firms disclose 17% less information than non-connected firms. These findings validate the results obtained in Table 5.8 from the firms in the textile and sugar sectors.

In order to analyse the voluntary disclosure practices of politically connected and non-connected firms in greater depth, the level of disclosure across various corporate governance constructs was also calculated. The following section provides a comparison of voluntary disclosure practices of politically connected and non-connected firms across various corporate governance constructs.

*a) Voluntary Disclosure across Corporate Governance Constructs*

- *Sugar and Textile Sectors*

Figure 5.17 presents a comparison between the percentage disclosure for various corporate governance constructs across politically connected and non-connected firms in the sugar and textile sectors. The figure highlights that the disclosure of all constructs is visibly higher for non-connected firms. The margin of disclosure on the construct of accountability between connected and non-connected firms is 25% (that is,  $88\% - 63\% = 25\%$ ). This margin is 12% in the case of executive/director remuneration, 14% for the construct of independence, 11% for profile, and 13% for roles, responsibility and inter-relationships.

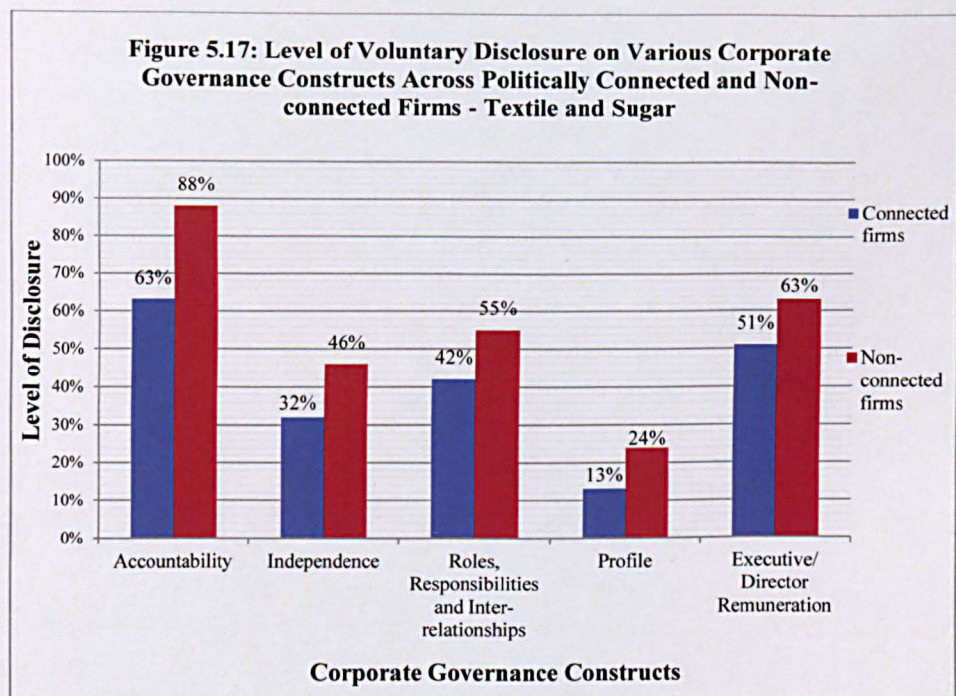


Table 5.10 provides information on the calculation of the level of disclosure across politically connected and non-connected firms in the sugar and textile sectors.

**Table 5.10: Voluntary Disclosure on Various Corporate Governance Constructs across Politically Connected and Non-Connected Firms – Textile and Sugar**

	<b>No. of Items in Each Construct</b>	<b>Maximum Obtainable Score = No. of Items in Each Construct × No. of Years × No. of Firms</b>	<b>Actual score obtained by all connected firms</b>	<b>Percentage of disclosure in connected firms</b>	<b>Actual score obtained by all non- connected firms</b>	<b>Percentage of disclosure in non- connected firms</b>
<b>Accountability</b>	4	200	125	63%	175	88%
<b>Independence</b>	7	350	113	32%	161	46%
<b>Roles, Responsibility and Inter-relationships</b>	13	650	272	42%	359	55%
<b>Profile</b>	8	400	51	13%	97	24%
<b>Executive/ Director Remuneration</b>	7	350	178	51%	221	63%

The second column of the table provides the number of items in each construct. The third column provides the maximum obtainable score across all connected firms. It is obtained by multiplying the number of items in each construct by the number of years (5) and then by further multiplying it by the number of politically connected firms (5) in each sector. For example, in the construct of accountability the number of items is four. Thus, the maximum obtainable score is calculated as  $4 \times 5 \times 10 = 200$ .

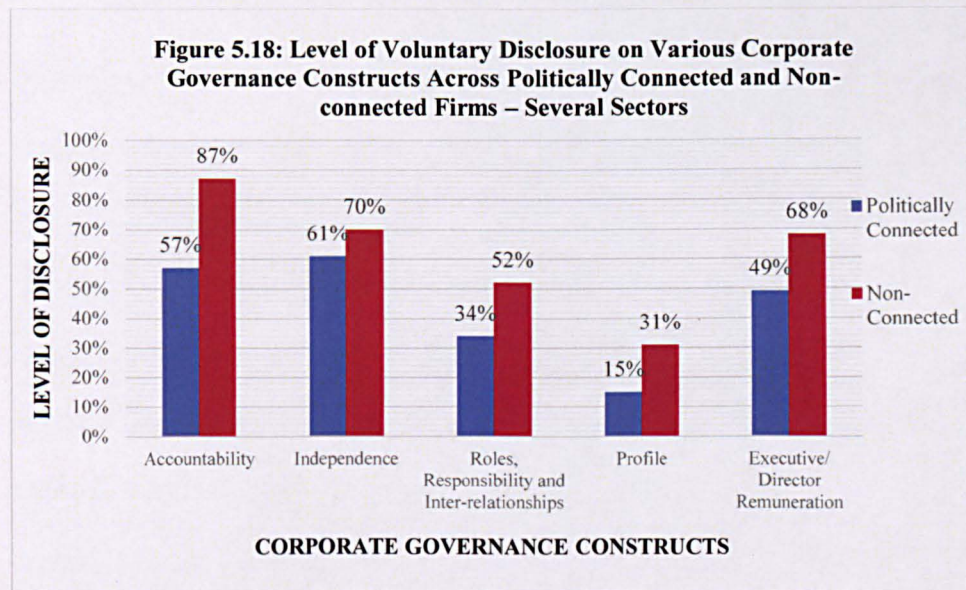
Column four provides the actual score obtained by politically connected firms on each corporate governance construct. The level of disclosure in column five of the table is calculated by dividing the actual score obtained by connected firms by the maximum obtainable score. Thus, the level of disclosure on accountability in politically connected firms is calculated as  $125/200 \times 100$ , which is equal to 63%. The disclosure in non-connected firms has been calculated in a similar way to the last column of the table.

- ***Several Sectors***

Figure 5.18 presents a comparison between the percentage disclosure for various corporate governance constructs across politically connected and non-connected firms in the several sectors group. This figure also shows that the disclosure of all constructs is visibly higher for non-connected firms in comparison with connected firms. The margin of disclosure on the construct of accountability between connected and non-connected firms is 30%; that is,  $57\% - 87\% = 30\%$ . This margin is 19% in the case of executive/director remuneration, 9% for the construct of independence, 16% for profile and 18% for roles, responsibility and inter-relationships. These results validate the results obtained from the analysis of firms in the sugar and textile sectors. It



might be observed that politically connected firms disclose a lower level of voluntary information on each construct of corporate governance, regardless of their sector/industry affiliation.



Based on the results obtained from the analysis of voluntary disclosure in the textile, sugar and several sectors groups, it might be observed that the construct of profile includes the provision of information regarding directors' qualifications, experience, skills and competence, and the corporate governance training attended. It may be argued that the provision of such information in annual reports does not have any economic impact. Thus, politically connected firms should not restrain the flow of such information. However, Figures 5.17 and 5.18 show that the level of disclosure in politically connected firms on this construct is only 13% in the textile and sugar sectors and 15% in the several sectors group.

The analysis could further be linked to the political environment in Pakistan because, according to the provisions of *Conduct of General Elections Order (2002)*, every candidate for parliamentary elections must be a graduate

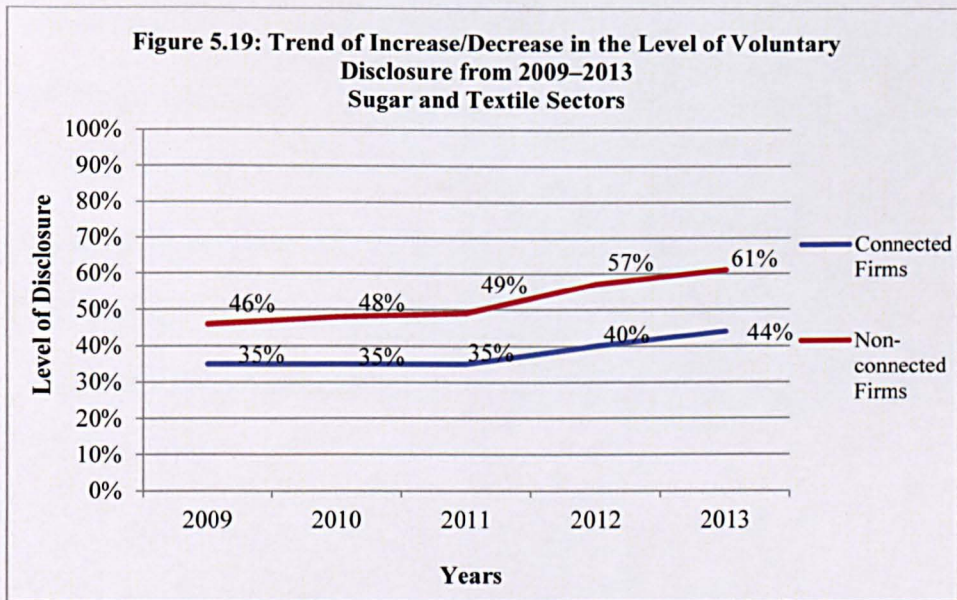
possessing a bachelor degree. Therefore, the qualifications disclosed by a politically connected member of the board might also have an impact on her/his political career, which may be a reason for non-disclosure of such information. Another explanation for this poor disclosure on profile may be found in the argument that politically connected members of the board are not qualified enough and thus do not disclose such information. Similarly, a lower level of disclosure on accountability might reflect that politically connected firms do not consider themselves accountable for shareholder value creation, strategic decision making and disclosure of information. These findings support the theoretical propositions drawn earlier in Chapter 3 that the board members of politically connected firms might be opportunistic and focus on maximising their political interests and in order to hide their activities, they restrain the flow of corporate governance information.

***b) Trend of Increase/Decrease in the Level of Voluntary Disclosure from 2009–2013***

- ***Textile and Sugar Sectors***

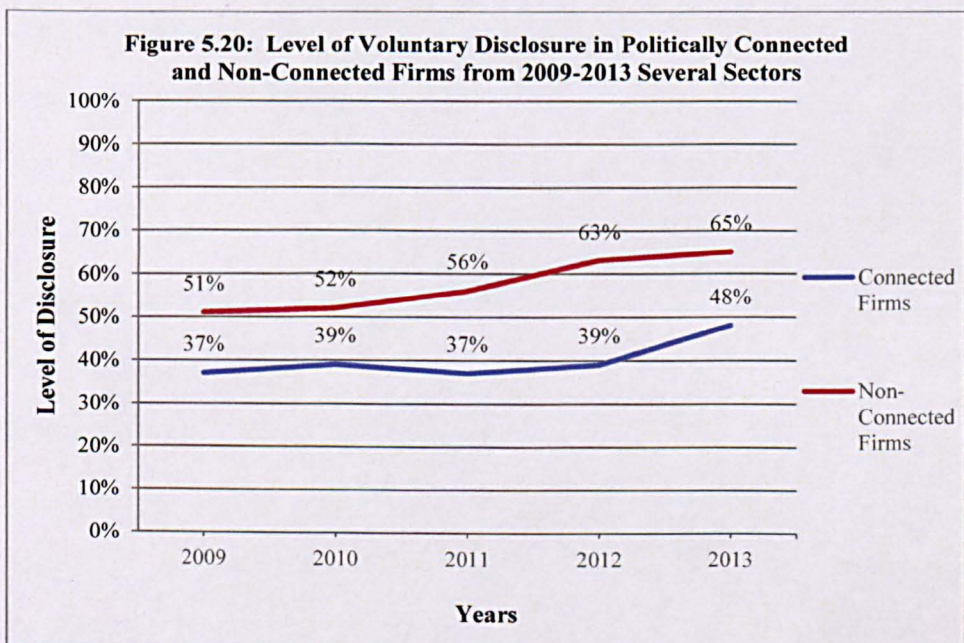
Figure 5.19 below shows an increasing trend in the level of disclosure by both politically connected and non-connected firms. However, the level of disclosure in non-connected firms has remained noticeably higher at each point in time during the years under analysis.





- **Several Sectors**

Figure 5.20 also demonstrates a rising trend in the level of disclosure by both politically connected and non-connected firms. These figures also show that the level of disclosure in non-connected firms remained higher compared with politically connected firms at every point in time.



The evidence found in this section endorses the results obtained in section 5.1.2 and the findings are in accordance with the following theoretical propositions of agency theory and rational choice institutionalism.

- Politically connected firms face a double agency problem. Members of the board have utility maximising preferences; hence, for meeting their self-interests they opt for such actions that are not favourable for (minority) shareholders.
- In order to hide their politically motivated, rent-seeking activities, they constrain the dissemination of information to shareholders, leading to a poor quality of corporate governance disclosure.

However, a deeper analysis of the data in this section indicates a problem in the way in which agency theory has been interpreted and analysed by quantitative researchers. As argued by Wiseman et al. (2012), most of the existing quantitative researchers have relied on the simplistic interpretation that agents want to maximise their *economic* wealth, while minimising their own efforts (through behaving negligently). This overly simplistic interpretation of self-interested human nature has resulted in an over-emphasis being placed on calculating utility through econometric analysis. However, as indicated by the results of this study, politically connected companies face the monetary risk of being penalised; yet they still do not attend corporate governance trainings or improve their qualifications. It may then be interpreted that they are not *interested* in being educated. Although this form of self-interest is not monetary, it has a potential to affect adversely the rights of minority shareholders whose funds are handled by incompetent directors.

As has been discussed in Chapter 3, prior research on the impact of political connectedness on corporate disclosure presents contradictory results. Many of the existing researchers argue that politically connected firms provide poor quality financial disclosure owing to difficulties in the valuation of network/relationship based assets<sup>27</sup> (Fan et al., 2014), lack of incentives to compete for external resources (Huang et al., 2014), less fear of scrutiny from regulator (Stuart and Wang, 2014), difficulties in accurate forecasting (Chen et al., 2010) shirking and rent seeking (Riahi-Belkaoui, 2004; Bushman et al., 2004) and the lack of market pressure (Chaney et al., 2011). The findings of the content analysis in this study support the results of existing empirical research in the field as politically connected firms were found to provide poor corporate governance disclosure. However, the analysis of data does not support the findings of Batta et al. (2014), who argued that politically connected firms provide a better quality of accounting disclosure because they do not face the risk of expropriation from the state. The results of this research support the findings of those other studies that found a lower level of disclosure in politically connected firms.

The above results have been obtained through an analysis of the level of disclosure in the annual reports of the firms, calculated through the development of ordinal measures. For the purpose of triangulating the findings of content analysis, interviews were conducted with the representatives of listed companies in the sugar and textile sectors, statutory audit firms and regulatory bodies. Interview data so collected not only validated the results of content analysis, but also provided a deeper understanding of the reasons for

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<sup>27</sup> According to Fan et al. (2014) political networks bring benefits to the firms and therefore they carry value. The value of these assets is separate from the value of standard assets of the firm.

the disclosure practices of politically connected companies. The analysis and findings of interview data are discussed in detail in Chapter 6.

Furthermore, in order to develop an in-depth awareness of how politically connected firms disclose information in their annual reports, an analysis of silence in these reports was undertaken. The analysis of silence has provided a deeper understanding of the level and depth of corporate governance information in the annual reports. In addition, it highlighted the differences in the disclosure practices of politically connected and non-connected firms as it was found that the annual reports of politically connected firms become silent on the disclosure of voluntary corporate governance information when compared with the annual reports of non-connected firms. The following section provides the analysis of silence in the annual report narratives.

### **5.2 Analysis of Silence in Annual Reports – Results**

In order to gain deeper insights into the disclosure practices of politically connected and non-connected companies, the technique of analysis of silence was utilised. The content analysis above provided an account of the level of overall disclosure across industries along with an explanation of variation in the level of disclosure in politically connected and non-connected firms.

The analysis of silence enabled a further in-depth investigation. According to the initially developed theoretical propositions of this research, politically connected firms were expected to hide information, or to refrain from provision of information regarding their corporate governance practices. The analysis of silence therefore investigates how the flow of corporate governance information is avoided through the use of silence as a tool.

The analysis of silence provides further insights into the second and third questions of this research. All the annual reports were in the English language and no translation was thus required. Drawing on the technique for analysis of silence used in previous research (Chwastiak and Young, 2003; Morison and Macleod, 2013), as explained in detail in Chapter 4, the disclosure of corporate governance practices was analysed to identify the absence of information.

The findings of this section are based on the analysis of silence in the narrative sections of the 200 annual reports. The annual reports of 40 listed companies were read over the period of five years (excluding financial statements) and information on the constructs of corporate governance was analysed. Initially, the annual reports of the firms from sugar and textile sectors were analysed. Later on, the analysis was extended to the annual reports of the firms in the several sectors group. Section 5.2.1 provides a discussion of the results obtained from the analysis of silence on voluntary corporate governance information in the annual reports of politically connected and non-connected firms in sugar, textile and several sectors groups.

### **5.2.1 Voluntary Disclosure**

As explained in Chapter 4 Section 4.3, five constructs of corporate governance disclosure were developed after the review of relevant literature. These constructs serve as the basic dimensions of corporate governance information for this research. This section provides a comparison of corporate governance information in the annual reports of politically connected and non-connected companies. Such a comparison allows for the identification of various instances where the information on various corporate governance constructs was totally absent, limited or constituted empty speech in these annual reports.

The following discussion reveals how politically connected companies use silence as a tool for controlling the flow of information in annual reports.

### *Accountability*

As explained earlier in chapter 4, the construct of accountability contains information on the firms' accountability regarding shareholder value creation, strategic decision making, compliance and disclosure of information to shareholders. The board of directors is chosen by shareholders to protect their interests and is responsible for shareholder value creation (Green and Graham, 2005). Therefore, the construct of accountability includes information regarding shareholder value creation through an increase in earnings, profitability, dividends and share price.

The analysis of narrative sections in the annual reports of non-connected firms in all sectors revealed that the information provided on board's accountability regarding shareholder value creation is detailed, and covers a wide range of related issues. The annual reports of all non-connected firms state that profitability and shareholder value creation formed the main objectives of these firms. For example the Annual Report of T7 for 2009 stated

*We are committed to becoming the premier manufacturing organisation in the textile industry...with the object of maximizing returns for all the stakeholders*

Annual Report of T6, a non-connected firm from textile sector for 2013 also stated

*The Company is primarily focused on the following areas:*

- *To achieve sustainable growth in revenue of the Company*

- *To diversify the product portfolio to yield high margins*

In addition to the statements elaborating board responsibility, the annual reports of non-connected firms also stated the strategy devised for enhancement of shareholders value. For example the annual report of a sugar sector firm S10 for 2012 stated that

*The Company has decided to further enhance the production capacity of the plant and is confident that (our new distillery unit) will bring further financial benefits to the Company and its shareholders in the years to come.*

T6, a firm from the textile sector stated in its annual report for 2012

*A responsible value creation can make a way to profitable long term growth which is our aim.*

Most of the non-connected firms expressed their concern about and responsibility for growth, profitability and value creation at multiple instances in each annual report. For example, the annual reports of SS14 (a chemical sector firm), SS16 (a food sector firm) and SS20 (a paper sector firm) provided statements expressing their concern for shareholder value creation; that is recurrently, in different sections and at different pages throughout the annual reports in all the years under analysis. Furthermore, non-connected firms explicitly set out the difficulties and challenges faced by the management in increasing profitability.

*The management is continually striving towards cost controls and efficiencies both in terms of production, financial and energy management.*

(T8, Annual Report 2013).

However, in addition to the recognition of hurdles, these reports also explained the strategic decisions taken by the management to overcome the problems identified. Non-connected firms explained the strengths and weaknesses of the company and also elaborated how management is working to convert the company's weaknesses into strengths, ultimately leading to profitable operations.

*In spite of the difficulties being faced we are determined to grow.*

*We are looking for ways to convert weaknesses and threats into strengths and opportunities...this value can be increased only through marked improvement in quality, market tie-ups, image building and change in business philosophy.*

(S6, Annual Report 2009)

*The company will be able to achieve satisfactory levels of profitability in the future based on plan drawn up by the management for this purpose and bringing its liabilities to serviceable levels and availability of the adequate working capital from its lenders and sponsors.*

(T9, Annual Report 2013)

These examples show that the non-connected firms have a strong commitment towards the growth and profitability of the company. Most of the annual reports of the non-connected firms also provided a statement of value addition. The emphasis placed on better profitability and the information on strategies for achieving better returns reflects how the directors of these firms render themselves accountable to shareholders in this regard.



Strong evidence of silence was found in the annual reports of politically connected firms, when compared to non-connected firms, regarding assumption of responsibility on shareholder value creation. The analysis of data in annual reports of the politically connected firms revealed that politically connected firms stated that the aim of these firms is to provide '*competitive return*' to the shareholders (T1, Annual Report 2013) and to '*benefit the customers, employees and shareholders*' (T3, Annual Report 2013). These annual reports also referred to their '*endeavour to enhance the value of shareholders*' (S1, Annual Report 2010) and to maintain the '*tradition of high yield and handsome returns to shareholders*' (S3, Annual Report 2013). However, these accounts appeared as a part of the standard vision and mission statements in most of these reports; which remained unchanged during the period of analysis. There was a lack of detailed and obvious disclosure beyond these standard statements.

Among all the politically connected firms, the annual report of only one firm - that is T5 - explicitly communicated the responsibility of management towards shareholder value creation. Going a step further the annual report of T5 expressed the willingness and commitment of the management to make an effort for to achieve better financial results.

*Our mission is to be a dynamic, profitable and growth oriented company by providing good return on investment to its shareholders and investors*

(T5, Annual Report 2013)

Standing out as an exception among the annual reports of politically connected firms, the annual report of T5 not only assumed the responsibility for good returns on investment but also expressed the concerns of management and the steps taken to attract customers and maximise the utilisation of organisational resources that might lead to the attainment of better financial results.

*The management is making stern efforts to attract more customers for optimal utilisation of available facilities to make further improvements in financial results.*

(T5, Annual Report 2011)

All other politically connected firms remained silent regarding the board strategy for enhancement in shareholder value, the challenges faced by management for improving shareholder profitability, and, expression of an intention to grow despite difficulties through effective future strategy. Thus these annual reports provided limited and standard disclosure and covered minimal range of information related to board accountability in regard to shareholder value creation.

The second element in the construct of accountability is responsibility towards strategic decision making. The in-depth analysis revealed that all the non-connected firms disclosed information on strategic decision-making of the firms during all the years from 2009 to 2013. Most of these reports outlined company strategy under a separate head; for example, *future strategy and prospects* (T9, Annual Report 2009), *our strategy* (T7, Annual Report 2011), *strategic objectives* (S6, Annual report 2013), *planning and coordination* (T10, Annual Report 2013) and *Statement of Strategic Goals* (SS20, Annual Report

2009). The provision of firms' strategic objectives under a separate heading in the annual reports of these firms highlights the importance placed by the board on this aspect of disclosure.

Furthermore, the annual reports of non-connected firms also allocated separate sections to information about various committees of the board along with the provision of the CEO and the Chairman's message. SS12 contained both *CEO's message* and *Chairman's message* outlining the company's strategic objectives and direction in detail, in all the annual reports from 2009 to 2013. SS20 provided *Chairman's message* and also provided details regarding the names and composition, the number of meetings and the role and responsibilities of various board committees under a separate section entitled *Information on Board Committees* for all of the five years. SS11 also contained *CEO message in all of its annual reports*, while SS16 contained CEO's message under the head *Chief Executive's Review*. Among politically connected firms, only one firm provided *Chief Executive's Review*, while another has provided information about its Management Committee. All the other firms remained silent.

All the reports of the non-connected firms outlined a generic company strategy and provided strategic outlines, followed by the techniques used by the management for the achievement of corporate objectives. In addition to these generic strategy statements, non-connected firms presented their future plans with regard to the actual happenings and events taking place in the firm's outer environment, so outlining the company's strategy to overcome the challenges and achieve the desired outcomes. For example, the 2009 annual report of T10, a non-connected textile sector firm provided information on the strategic

decisions regarding cash flow and reputation management. The report also stated that all the strategic decisions and subsequent actions were taken after making an allowance for a challenging industry environment.

*The challenging business climate has provided an opportunity to pursue a business transformation and streamline our journey to position your company strongly for the future...on the business front, your company has experienced marked improvements on overall cash flow with tighter cost control and better credit management. In overall stakeholder and reputation management, we managed to advocate our views on all issues confronting the industry, ensuring that we are all abreast with industry change and are able to meet the challenges.*

In another example, the 2012 annual report of S7, a non-connected firm from the sugar sector provided information on the strategic decision of the company to raise funds for expansion of its operations in the following manner:

*The Company is actively engaged in considering to broaden its operations. For its future plans, the management is weighing various options to raise finances. These options include enhancing its paid up share capital, which currently is inadequate as compared to other comparable entities. Decision in this regard shall be taken after complete deliberation from all major stakeholders.*

Similarly, under the heading of ‘future strategy and threats’, the 2010 annual report of T9, a textile sector firm also elaborated the challenges faced by the

company in the external climate of the company and then outlined the strategic steps taken by the directors to deal with those challenges.

*Our long overdue gas connection application is now under serious consideration by SNGPL<sup>28</sup> and we are hopeful of a positive outcome shortly. Once we have the formal approval, the directors are committed to invest in a cogeneration power plant, which while providing cheaper and continuous power will also generate steam, thus resulting in huge saving of furnace oil cost. In addition to the Rs. 40 Million interest free loan from the Directors, the directors also intend to convert a portion of other interest bearing sponsors' loans into equity. Therefore, it has been decided to further enhance the authorized share capital by Rs 60 million from Rs 160 million to Rs 220 million.*

Annual report 2012 of SS16, a food sector firm, provided information about the formation of its Business Strategy and Planning Committee along with an elaboration of that committee's objectives and responsibilities. Some of the non-connected firms (for example, SS17, Annual Report 2012) stated that the formulation of company's strategy was the responsibility of the Management Committee.

In addition to outlining the future strategy of the company, these companies also provided reference to their previous strategic decisions, how they have implemented them and how successful those strategic decisions have proved. For example, the annual report of T7 for 2013, a textile sector company stated

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<sup>28</sup> Sui Northern Gas Pipelines Limited

*The Company's strategy, which was unchanged from last year, was to maintain optimal capital structure in order to minimize cost of capital.*

The annual reports of politically connected firms stayed silent on all these details. This tendency also highlights that the non-connected firms provide detailed, in-depth information regarding management's responsibility for strategy formulation, implementation and results.

The analysis of disclosure of information on accountability regarding strategic decision making in politically connected firms' annual reports demonstrated an absence of information in the various dimensions and areas covered, when compared to the non-connected firms. Only two of the politically connected firms provided information on their strategic goals and decision making, while this information was absent in the annual reports of all other politically connected firms'. Both of these firms provided this information in the form of a standard statement that remained unchanged during the years considered. For example, one of these firms - that is, T5 - provided a statement regarding its management's marketing strategy.

*The management adopted aggressive marketing strategies to boost exports in most competitive international markets.*

(T5, Annual Report 2011)

T5 continued to disclose the same information on its strategic decisions for all the subsequent years. In 2012, one more connected firm - namely T2 - also started disclosing information on its strategic decisions.

*Your Company's management has maintained its focus on Research and Development activities. Various projects are underway to increase efficiencies through machinery up-grading and replacements. Efforts are also made to broaden the customer base by emphasizing market development as well as product development*

(T2, Annual Report 2012)

As it was observed in the content analysis (Section 5.3), there was a positive trend in the level of voluntary disclosure across the years from 2009 to 2013. The analysis of silence in the annual reports supports the findings of the content analysis. The level of disclosure in politically connected firms gradually increased over time. In 2013, seven out of ten connected firms started to recognise the board's responsibility towards strategic policy making.

*Prompt and timely decision in right direction is the core objective of every management, particularly in an industry where the input costs are more volatile and subject to frequent change.*

(T3, Annual Report, 2013)

The analysis of silence revealed that politically connected firms did not provide any information about company's strategic objectives, as opposed to non-connected firms which had provided detailed information under separate heads. Furthermore, politically connected firms stayed silent on the past, present and future strategy of the company's management for handling challenges and difficulties. Furthermore, politically connected firms did not discuss the strengths and weaknesses of the companies in the context of firm's

environment. Lack of information on these aspects, when compared to non-connected firms highlights that these companies use silence as a tool for limiting corporate governance disclosure.

The third element in the construct of accountability is responsibility towards compliance. All the firms provided an explicit declaration that they assume the responsibility for complying with all the laws and regulations of the country, with a specific emphasis on corporate governance regulations. There were no observable differences in the narratives of the annual reports across politically connected and non-connected firms. It might also be linked back to the findings from content analysis, whereby the level of mandatory disclosure was adequate in both politically connected and non-connected firms. Thus politically connected as well as non-connected firms comply with corporate governance and also assume responsibility regarding compliance in annual report narratives.

Provision of information and disclosure was the fourth element in the construct of accountability. Among non-connected firms, 17 of the firms disclosed information on the disclosure policy of the company over all five years. Non-connected firms not only stated that they aim to disseminate all material information in a timely fashion, but that they also moved a step ahead, highlighting that the information provided should be transparent, reliable and timely.

*The Company acknowledges the trust and confidence that our investors and bankers repose in us. The Company maintains good relationship with investors and communicates with them through meetings. It disseminates information in timely manner.*



(T6, Annual Report 2013)

*The management of your company believes in good corporate governance, implemented through a well-defined and efficiently applied system of check and balance and the provision of transparent, accurate and timely information.*

(SS19, Annual Report 2011)

Of the politically connected firms, five of the firms provided information about their approach towards disclosure over all five years, while two politically connected firms started providing information about their approach towards disclosure in the annual reports from 2012 onwards. For example, the annual report 2013 of S3 stated

*The Board aims to ensure that the Company's shareholders are timely informed about the major developments affecting the Company's state of affairs. To achieve this objective, information is communicated to the shareholders through quarterly, half-yearly and annual reports, now being promptly placed on Company's website.*

It might therefore be inferred that only a limited number of politically connected firms assumed responsibility for the provision of information and disclosure, while the rest remained silent. Furthermore, these firms remained silent on such issues as the materiality, timeliness and transparency of the disclosure provided. Even in the annual reports of those politically connected firms that showed a commitment towards disclosure, the provision of information was noticeably less compared to non-connected firms.

The analysis of silence highlights that the non-connected firms provide a detailed account of all the aspects relating to accountability. These firms not only provide information on the various aspects of accountability, but they also move beyond the provision of traditional statements and provide actual examples of the strategic decisions, value addition and profitability. They also provide references to firms' policies and practices during the past and outline the company's future plans. Moreover, with regard to disclosure, they not only take the responsibility of disclosure of information, but also recognise reliability and transparency to be important features of the disseminated information. While politically connected firms also provide information on these aspects, they stay silent regarding their commitment for value addition to the shareholders, their actual strategic plans, and timeliness and integrity of the information provided by the firm.

These findings support the results obtained from content analysis (explained in Section 5.1.3), which revealed that the level of disclosure on the construct of accountability in politically connected firms was considerably lower than non-connected firms. The content analysis showed that the level of disclosure on the construct of accountability in the sugar and textile sectors was 63%, while the level of disclosure in non-connected firms was 88%. On the other hand, the level of disclosure in politically connected firms in the several sectors group was 57% in politically connected and 87% in non-connected firms.

### ***Independence***

The construct of independence contains items relating to the separate role of CEO and chairman, number of independent directors, the independence of the audit committee and the independence of HR and remuneration committee.

The annual reports of almost all of the politically connected firms provided information on the separation of the CEO and the chairman over all five years. These reports were, however, silent on the disclosure regarding the number of independent directors from the years 2009 to 2011. An incidence of empty speech was observed in these reports as most of these reports narrated:

*The Company encourages representation of independent non-executive directors representing minority interest on its board of directors.*

(T5, Annual Report 2011)

However, no information was provided in these reports about the actual number of independent directors on the board. Another interesting observation in this regard was the confusion in the use of the words ‘independent’ and ‘non-executive’, with these words being used interchangeably. Subsequent to the expression of their commitment towards representation of independent directors, politically connected firms actually provided information on the number of non-executive directors, instead of independent directors.

*The company encourages representation of independent non-executive directors. At present, the Board includes four non-executive directors.*

(T4, Annual Report 2011)

With regard to the independence of audit committee, the politically connected firms stayed silent until 2013 while, with regard to the independence of the HR and remuneration committee, information was provided by most of the connected firms in 2012 and 2013.

In contrast to the politically connected firms, most non-connected firms disclosed the status of separation in the role of CEO and chairman during all the years under consideration. The number of independent directors was also disclosed by most of the firms from 2009 to 2012, while in 2013 all non-connected firms disclosed this information. Moreover, these firms also explicitly stated the criteria used for determining the independence of the directors:

*The independent directors meet the criteria of independence under clause i (b) of the CCG*

(T6, Annual Report 2013)

The information regarding the independence of audit committee was also provided by most of the non-connected firms during 2009. These firms disclosed this information in 2012 and 2013. Information regarding the independence of HR and Remuneration committee was provided by one of the firms before 2011. However, from 2011 onwards, all the non-connected firms provided this information. The overall depth and detail of disclosure in the reports of non-connected firms was much better than connected firms. These results support the findings of content analysis in Section 5.1.3 where the level of disclosure on the construct of independence in the annual reports of politically connected firms was considerably less than for non-connected firms. The level of voluntary disclosure in the construct of independence in the sugar and textile sectors was 32% for politically connected firms and 46% for non-connected firms respectively. On the other hand, the level of disclosure in several sectors group was 61% for politically connected firm and 70% for non-connected firms.

***Roles Responsibility and Inter-relationships***

The annual reports of non-connected firms provided information on all the items in this construct. However, the detail and depth of disclosure was better for some of these items, when compared to politically connected firms. For example, the annual reports of all the non-connected firms disclosed information on the duties of the board. Some of these reports stated that the directors were well aware of their duties.

*The directors of the Board are well aware of their duties and responsibilities as outlined by corporate laws and listing regulations.*

(T6, Annual Report 2013)

However, some of the non-connected firms also stated the expectations regarding the role that the board members were expected to perform in the company. For example, the 2010 annual report for T7 provided the following list of responsibilities towards various stakeholders.

*Shareholders: Protection of shareholders' investment, and providing acceptable return on investment.*

*Customers: Winning and retaining customers by developing and supplying products and services which offer value in terms of price, quality, safety and environmental impact, which are supported by the requisites technological, environmental and commercial expertise.*

*Employees Respecting the rights and obligations for the employees:*

- *Good and safe conditions at work*

- *Competitive terms and conditions of services*
- *Development and best use of human resource*
- *Equal opportunity employment regardless of cast, creed, colour or sex*

*Business associates: Seeking mutually beneficial relationships with customers and suppliers*

*Society: Conducting business as a responsible corporate citizen.*

*State: Complying with all requirements of laws and regulations.*

The annual report of T8, a textile sector non-connected company also outlined what practices were expected of the members of the boards.

*All Directors and employees are expected to practice the following core values:*

*Honesty: Honesty in dealings with persons within the organisation and outside*

*Integrity: Conduct of affairs in an upright manner at all times including avoidance of any type of conflict of interest.*

*Loyalty: Demonstrate loyalty towards the Company, the customers and all stakeholders.*

Non-connected firms also provided detailed information about various committees of the board and elaborated the roles and responsibilities of each of those committees. In a similar fashion, all the non-connected firms also provided information about buying/selling or other transactions in company shares. These firms provided detailed information on the opening balance, the

shares purchased/sold and the closing balance for all the directors, CEO and their spouses/minor children. Disclosure of the rest of the items within this construct was similar to that of politically connected firms.

The analysis of silence revealed that all the politically connected firms provided information on the number of directors, board meetings, attendance details, boards' approval for company's risk management policies and responsibility towards internal controls. However, on disclosure regarding the duties of the board, a complete silence was observed in the annual reports of politically connected firms. The annual reports of politically connected firms stayed silent regarding expectations from the members of the board. Only six of the firms disclosed information on their directors' transactions in buying/selling in company shares, while only one politically connected firm provided information about the opening and closing balance of shares held by the directors.

It might be inferred from these examples that, while non-connected firms provided detailed information on all the above governance items, the politically connected firms either stayed silent or provided superficial information, which indicates an incidence of empty speech.

### ***Profile***

In alignment with the results of content analysis above, the overall level of voluntary disclosure on the construct of profile was also very poor and there was not much difference in the level of disclosure between politically connected and non-connected firms for this construct. However, the analysis of silence revealed that the difference in the percentage of score obtained on this

construct mainly arose due to the provision of detailed information on this construct in eight of the non-connected firms' annual reports in 2013.

The annual reports of T6, T7, S10, S9, SS16, SS17, SS19 and SS20 provided detailed information about the qualifications and experience of the directors. The annual report of T7, SS16, SS17, SS19 and SS20 provided coloured pictures of the board members, their age, experience and the names of other firms in which they held directorships. Similarly, the annual report of T6 SS16, SS17, SS19 and SS20 provided detailed information about the profile of the board members, including their qualifications, experience and directorships held in other companies. The annual report of S10 and SS20 also provided brief biographies of the directors. All of the politically connected firms remain completely silent on these matters.

### ***Executive/Director Remuneration***

The analysis of silence revealed that the remuneration package in the annual reports of non-connected firms, provided greater details of various incentives provided to the executives and directors. For example, these firms supplied information on the company's provident fund contribution, leave encashment, the sum paid in lieu of CEO's residential and telephone expenses, the fees paid to directors for attending audit committee meetings, the companies' health and insurance plan for directors and their dependents.

Amongst the politically connected firms, the annual reports of four firms stayed completely silent about CEO remuneration until 2013. The remainder of the firms also provided limited information about director/executive remuneration. These firms provided information on their remuneration package



under sub-headings such as, managerial remuneration, utilities, house rent allowance, other allowances and conveyance. However, a complete silence was observed regarding such information as provident fund contribution, residential expenses, phone expenses, and health and insurance plans.

It might be inferred from the analysis of silence that politically connected firms stayed silent in regard to the majority of voluntary disclosure items. The information provided was superficial, inadequate, covered a limited range of issues and lacked depth. Furthermore, these companies have not provided any information regarding management's actual corporate governance practices in relation to the companies' environment or past, present or future circumstances. Moreover, most of the information was added as a part of standard statements that remained unchanged in the annual reports during all the years under consideration. These findings support the results obtained from qualitative content analysis, whereby the level of voluntary disclosure in the annual reports of politically connected firms was observed to be considerably low in comparison to non-connected firms.

These findings are consistent with the findings of various cross-country studies which argue that politically connected firms do not disclose good quality corporate information (Riahi-Belkaoui, 2004; Bushman et al., 2004; Chaney et al., 2011). These findings also support the initial theoretical propositions, whereby it was proposed that politically connected members of the board are self-interested and opportunist, maximising their political interest at the cost of minority shareholders rights. In order to hide their political rent seeking, these politically connected members of the board might then restrain the flow of

corporate governance information in annual reports, resulting in limited disclosure about corporate governance practices of the firm.

### **5.2.2 Mandatory Disclosures**

The analysis of silence on mandatory disclosure items did not provide good insight into the phenomena under study. The reason for it not being very meaningful was because, as it might be expected, companies followed the standard format for the statement of compliance with corporate governance regulations as issued by the Securities and Exchange Commission of Pakistan. Most of the firms included the same format as a part of their annual report. There was hence no variation in the language, amount, depth, style or structure of the information.

However, an interesting observation in this regard was that, for the items where mandatory information was not disclosed, the companies became ‘silent’ and omitted the information from the standard format of the statement. Neither compliance nor non-compliance with the regulation was thus stated. For example, most of the annual reports before 2013 stated that they encourage the representation of independent directors on the board. However, they did not disclose the number or names of independent directors.

### **5.3 Conclusion**

This chapter has examined corporate governance disclosure practices of politically connected and non-connected listed companies from various industries in Pakistan. The findings of the analysis of disclosure in annual reports support the initially developed research propositions, whereby, owing to the presence of agency conflict, the level of voluntary information was

found to be poor in all the firms. However, corporate governance regulations have worked towards reduction of this conflict and firms have disclosed a better level of mandatory corporate governance information in the annual reports.

The research findings also support the initially developed research proposition regarding the influence of political connectedness. It was anticipated that politically connected members of the board might have utility maximising preferences and, to satisfy their self-interest, they opt for such actions that are not favourable for (minority) shareholders. In order to hide their politically motivated, rent-seeking activities, they might thus constrain dissemination of information to shareholders, leading towards a poor quality of corporate governance disclosure. The results of the content analysis have shown that the level of mandatory (Section 5.1.2) as well as voluntary (Section 5.1.3) disclosure in the annual reports of politically connected firms is poor in comparison with non-connected firms.

It was also found that the level of disclosure varies on various corporate governance constructs. For example, the level of disclosure in regard to the construct of accountability was higher, while the level of disclosure on the constructs of profile was lower in all the industries and among politically as well as non-connected firms. The findings from the analysis of silence (Section 5.2.1) support the findings of the content analysis; that is, the amount, and depth of voluntary disclosure by non-connected firms was much better, and they provided more in-depth and detailed disclosure compared to connected firms.

The analysis of annual report data also revealed that there was no difference in the disclosure practices of the companies across industries, being that there was a similarity in the level as well as the trend of disclosure on various corporate governance constructs in both industries. The findings from the content analysis and the analysis of silence were further triangulated with the findings from the interview data analysis. The interviews were conducted with key personnel from the listed companies, regulators and audit firms in Pakistan. The results of interview data are provided in the next chapter.

## **Chapter 6 – Interpreting Interview Data**

### **6.0 Introduction**

Chapter 2 of this thesis outlined the institutional background in which the research was carried out. Chapter 3 provided an account of the prior literature and explained the theoretical foundations of this research. Chapter 4 outlined the research methodology along with an explanation regarding the choice of the research methods. Chapter 5 outlined the results obtained from the content analysis of the annual reports along with an in-depth analysis of silence on corporate governance practices in the annual report narratives of the listed companies.

As explained earlier in Chapter 4, for the purpose of gaining a deeper insight into the corporate governance disclosure practices of the listed companies, semi-structured interviews were also conducted during the process of research data collection. Template analysis was carried out for the purpose of interpreting interview data. This chapter outlines the analysis and findings from the interview data. The results obtained from the analysis of interview data have enabled triangulation and thus strengthened confidence in regard to the findings of this research.

Figure 6.1 below shows how Chapter 6 is positioned in the thesis.

**Figure 6.1: Chapter 6 – Positioning in the Thesis**

<b>Identification of Research Gap:</b> The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Research Rationale</li> <li>- Personal Motivations for the Study</li> <li>- Research Objectives and Questions</li> <li>- Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Background to the Study</li> <li>- The Institutional Framework in Pakistan</li> <li>- Capital Market</li> <li>- Corporate Governance and Reporting Regulations</li> <li>- Pakistan's Institutional Context: Relevance with Other Developing Countries</li> <li>- Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Political Connectedness</li> <li>- Political Connectedness in Developing Countries</li> <li>- Corporate Governance and Disclosure Practices</li> <li>- Political Influence and Corporate Disclosure</li> <li>- Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>- Identification of Research Gaps</li> <li>- Contributions of this Research – Addressing the Existing Gaps</li> <li>- Conclusion</li> </ul>
<b>Methodology Selection</b>	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Research Philosophy, Research Approach and Research Design</li> <li>- Data Collection Methods</li> <li>- Data Analysis</li> <li>- Ethical Considerations</li> <li>- Conclusion</li> </ul>
<b>Analysis and Discussion of Findings</b>	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Qualitative Content Analysis</li> <li>- Analysis of Silence in Annual Reports</li> <li>- Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>- The Influence of Political Connectedness on Corporate Governance Disclosures</li> <li>- Conclusion</li> </ul>
<b>Findings and Conclusion</b>	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>- Introduction</li> <li>- Findings of the Research</li> <li>- Contributions to Knowledge</li> <li>- Quality of Research</li> <li>- Limitations of the Study and Directions for Future Research</li> </ul>

This chapter is organised as follows. Section 6.1 will explain the corporate governance disclosure practices of companies in Pakistan. Section 6.2 explains the disclosure practices of politically connected firms, while Section 6.3 offers some conclusions.

The following section will address the first sub question of the research; that is, ‘How do listed companies in Pakistan disclose corporate governance related information in annual reports?’

### **6.1 How do Companies in Pakistan Disclose Information in Annual Reports?**

This research has investigated how corporate annual reports are prepared in the actual settings of the listed companies in Pakistan. Interviews were started by asking participants to describe the process of preparation of annual reports in listed companies and who were the preparers of the annual report. There was a high level of agreement among respondents from the listed companies, as they all stated that annual reports are prepared by the accounts and finance department of the companies. Table 6.1 summarises the evidence regarding the preparers the corporate annual reports.

Table 6.1: Preparers of Annual Reports

Nature of the Organisation	Firm	Examples	Prepared by:
Politically Connected Companies	Textile – A (Company secretary)	<i>‘Annual reports are obviously prepared by accountants.’</i>	<i>Accounts Department</i>
	Textile B – (Company secretary)	<i>‘One is the CEO. And the other one is CFO.’</i>	<i>CEO and CFO</i>
	Sugar – J (Chief Financial Officer)	<i>‘CFO does this as it is a financial report.’</i>	<i>CFO</i>
Non-connected Listed Companies	Textile C – (GM Finance)	<i>‘That is generally prepared by the accounts department.’</i>	<i>Accounts and Finance Department</i>
	Textile – D (Deputy Financial Controller)	<i>‘Annual reports are always prepared by Accounts Department, and auditors verify all information.’</i>	<i>Accounts Department</i>
	Sugar – I (Chief Financial Officer)	<i>‘The one who owns the financial statements, the financial department’.</i>	<i>Finance Department</i>



Table 6.1: Preparers of Annual Reports

Nature of the Organisation	Firm	Examples	Prepared by:
Statutory Audit Firms	Statutory Audit Firm – L (Partner)	<i>'The CFO of the company normally submits financial statements first to CEO and then to board of directors.'</i>	CFO and CEO
	Statutory Audit Firm – N (Partner)	<i>'All the core information will be coming from the accounts and finance department.'</i>	Accounts and Finance Department
	Statutory Audit Firm – O (Partner)	<i>'For all practical purposes, in Pakistan around 99% accounts are being prepared by the chartered accountant firms.'</i>	Statutory Audit Firms
Regulator	Regulator – S	<i>'Actually these are prepared by finance department or accounts department, well this is theoretically but practically chartered accountants (external auditors) prepare all accounts.'</i>	Statutory Audit Firms

### **6.1.1 Preparation of Annual Reports – The Process**

This information provided by the interview participants (Table 6.1) suggests that the accounting and finance department is mainly responsible for the preparation of annual reports. It is the ultimate responsibility of the Chief Financial Officer to prepare annual accounts, compile them in the form of a report and present them to the board of directors. These findings support the previous literature. For example, Haniffa and Cooke (2002) showed that annual reports are prepared by the chief accounting officer of the company.

The response from respondents S and O was, however, unexpected. Although respondent S was working in a key position in a regulatory department, the respondent explained that the statutory audit firms prepare annual reports for listed companies. Participation of statutory auditors in the preparation of annual accounts is a violation of International Financial Reporting Standards and raises questions about the independence of external audit function.

### **6.1.2 Role of Directors in Preparation of Annual Reports**

As stated earlier, the *Companies Ordinance (1984)* makes the directors responsible for the preparation of annual reports. According to the theoretical underpinnings of agency theory, the board performs the function of controlling and monitoring management's activities (Fama and Jensen, 1983). It is argued in the prior literature that the board oversees the preparation of corporate annual reports (Matoussi and Chakroun, 2008). Many researchers have also studied the impact of board characteristics such as board duality, proportion of independent directors and board size on disclosure through quantitative analysis (Bujaki and McConomy, 2002; Andersson and Daoud, 2005; Ben-

Amar and Boujenoui, 2006; Hossain, 2008; Samaha et al., 2012; Al-Najjar and Ding, 2014), and found contradictory results.

However, the prior literature remains silent on the real life process of preparation of the annual reports in listed companies and the role of the board of directors in this regard. This research has investigated these matters to gain deep insights into the conduct and role of the board of directors in the context of Pakistani companies. Table 6.2 summarises the responses regarding the influence of the board of directors on the preparation of corporate annual reports.

Table 6.2: Preparation of Annual Reports – Role of the Board

Nature of the Organisation	Firm	Examples	Nature of Directors Involvement
Politically Connected Companies	Textile – A (Company secretary)	<i>'Reports are prepared by CFOs, but they show them to directors.'</i>	<i>Monitoring</i>
	Sugar H – (Company secretary)	<i>'During the preparation of annual report, we keep consulting with the working directors...and keep getting their feedback.'</i>	<i>Active guidance and monitoring</i>
	Sugar – J (Chief Financial Officer)	<i>'The CEO...reads the entire report. Not all the directors. The concerned director which is our CEO...he gives us guidelines that how we could, improve the information.'</i>	<i>Active guidance and monitoring</i>

Table 6.2: Preparation of Annual Reports – Role of the Board

Nature of the Organisation	Firm	Examples	Nature of Directors Involvement
Non-connected Listed Companies	Textile C – (GM <sup>29</sup> Finance)	<i>'Board of directors read it word by word. Then they suggest corrections too.'</i>	<i>Active guidance and monitoring</i>
	Textile – E (CEO and Chairman)	<i>'Before he (the auditor) finalises the report he comes to me for clarifications.'</i>	<i>Active guidance and monitoring</i>
	Textile F – (CFO)	<i>'The things (in annual reports) are being decided by the management, management means board of directors.'</i>	<i>Active guidance and monitoring</i>
Statutory Audit Firms	Statutory Audit Firm – L (Partner)	<i>'The ultimate decision...that how information is to be used and reflected will be decided by the board of directors.'</i>	<i>Active guidance and monitoring</i>
	Statutory Audit Firm – N	<i>'If there is something in the report that they (the board) don't</i>	<i>Monitoring</i>

<sup>29</sup> General Manager

Table 6.2: Preparation of Annual Reports – Role of the Board

Nature of the Organisation	Firm	Examples	Nature of Directors Involvement
	(Partner)	<i>think right, they will not allow it, delete it.'</i>	
	Statutory Audit Firm – O (Partner)	<i>'There are 2-3 active directors who study and finalize these accounts.'</i>	<i>Monitoring</i>
<b>Regulator</b>	S – Regulator	<i>'Basically this is the responsibility of directors.'</i>	<i>Monitoring</i>

The examples in Table 6.2 show that directors have a profound impact on the preparation of annual reports in all the listed companies, irrespective of the status of their political connectedness. In most of the companies, the board members take an active part in guiding the accounting and finance department about the preparation of annual reports. Once the accounting and finance department prepares a first draft of the report, the members of the board read it and suggest changes/improvements.

Respondent H, a company secretary, explained that he collects all financial data from the accounting and finance department one month before the due date for submission of the report. He then prepares the draft of the report and submits it to the directors seven days before the board meeting. The members of the board raise questions and provide suggestions on the submitted draft during this board meeting. Therefore, it can be implied from this evidence that, in alignment with the agency theory perspective, the directors are performing an active monitoring role in the preparation of annual reports in the context of Pakistan.

Lau (2010) argues that in family controlled listed companies, decision making and management roles are held by the same individuals; that is, the controlling family members. The responses of some of the participants support this view being that the company secretaries and the CFOs explained that the board provides them with strategic guidelines on operations, financial matters and preparation of annual reports and closely monitors the everyday affairs of these companies. For example, Respondent H, a company secretary stated:

*‘During the preparation of the annual report, we keep consulting with the working directors; we share information with them from time to time and keep getting their feedback.’*

Therefore, the annual reports are prepared under the strong influence and advice of the board of directors. The management of the companies is given strict guidelines regarding preparation of annual reports from the directors. The directors not only read the annual report before presenting it in the annual general meeting, but they also advise amendments and improvements in the draft report. These findings also support the view that family owned companies are typically managed by the family members themselves. Therefore, the gap between owners and managers is minimal (Javid and Iqbal, 2010).

### **6.1.3 What to Disclose in Annual Reports? – Financial Information**

One of the key aims of the implementation of corporate governance regulations in Pakistan has been to boost investor confidence through an improved flow of financial as well as non-financial information (The World Bank, 2005). The existing literature emphasises the importance of narratives in annual reports and generally argues that narrative sections in the annual reports are to be used as a device for presenting a controlled impression regarding company affairs. Thus, corporate narratives are not merely expressions of accounting performance; rather they are drafted carefully for meeting firms’ strategic objectives (Merkel-Davies and Koller, 2012).

This research, however, found otherwise. During the process of analysis, it was observed that most of the respondents stated that annual reports comprised of financial/production data. The respondents considered that annual reports consisted of financial statements and were prepared to inform the readers about



the financial affairs of the company, while they totally ignored the disclosure on corporate governance and other non-financial/strategic aspects. Table 6.3 summarises the responses of various interviewees.

Table 6.3: Annual Reports are Financial Data

Nature of the Organisation	Firm	Examples	Annual reports are:
Politically Connected Companies	Textile B – (Company secretary)	<i>'The pattern of the report is pre-determined in the law...the balance sheet, the profit and loss, cash flows. Statement of changes in equities, notes.'</i>	Financial statements
	Sugar – H (Company secretary)	<i>'In the annual report we can see results of a complete full year, all production data, sales data, complete yearly expenses even which were planned but not yet done, so this report states the actual (financial) position of the company.'</i>	Financial data
	Sugar – J (CFO)	<i>'It is a financial report.'</i>	Financial report
Non-connected Listed Companies	Textile C – (GM Finance)	<i>'In the annual report there are various segments; one segment contains financial information...and the other segment that relates to certain requirements of the corporate governance.'</i>	Financial data + corporate governance disclosure

Table 6.3: Annual Reports are Financial Data

Nature of the Organisation	Firm	Examples	Annual reports are:
	Textile – I (Chief Financial Officer)	<i>'Annual reports are actually annual accounts.'</i>	<i>Financial statements</i>
	Textile – E (CEO and Chairman)	<i>'It is between the finance and the external auditor to finalise the balance sheet.'</i>	<i>Financial statements</i>
Statutory Audit Firms	L – Partner	<i>'There are six elements of financial statements balance sheet, profit &amp; loss, cash flow statement, statement of comprehensive income... equity, notes to the accounts.'</i>	<i>Financial statements</i>
Regulatory Body	S – Regulator	<i>'Chartered accountants prepare all accounts... they prepare annual reports.'</i>	<i>Financial data</i>

Table 6.3 shows that all the respondents from politically connected as well as non-connected firms stated that the annual reports comprise of financial information. No respondent, with the exception of respondent C considered that corporate governance and other non-financial information are also included in the annual reports. Respondent C, the GM finance from a textile company, talked about the provision of non-financial information in the annual reports. Respondent C talked in detail about various sections of the annual report, including non-financial information related to corporate governance. However, he later explained that his company had recently launched an investment project in a foreign country and the company was following international best practices. Several respondents also stated that, in Pakistan, multinational firms are providing good, voluntary disclosure in their annual reports.

*There are...some people who only fulfil the minimum requirement and there are some people who...are...multinational...who have foreign investments, who have to develop international relations or have to attract response from market...they are providing a lot of information.*

(I, Chief Financial Officer, Sugar Sector Firm)

Another participant said:

*If the company is a multinational company and it is a listed company on the stock exchange of Pakistan. In addition to the local requirements, they will make sure that the reporting is in line with their holding company's requirement, sitting back in any country, any part of the world.*

(B, Company Secretary, Textile Sector Company)

The evidence above highlights that while preparing annual reports, the companies in Pakistan pay considerably less attention to non-financial disclosures such as corporate governance, corporate social responsibility, company history and environmental disclosures. These findings do not support the existing literature on the value of narrative disclosures, whereby it is argued that companies use narrative sections in the annual reports for various purposes, such as impression management and the provision of additional useful information to the users (Merkl-Davies and Brennan, 2007; Cho et al., 2010). The results of this research indicate that there is a difference between the disclosure practices of domestic and multiple listed/multinational companies, whereby multiple listed companies will disclose more non-financial information. These findings are not surprising as the companies listed on stock exchanges are required to follow the regulation of the respective country and the results are in alignment with the existing literature (Collett and Hraskey, 2005; Andersson and Daoud, 2005)

It might be inferred from the above analysis that most of the participants considered that annual reports only constitute financial statements and corporate governance disclosures were totally omitted from their responses. Based on these findings, the researcher could have expected that the disclosure of corporate governance matters in the annual reports might be poor. However, the content analysis of the annual report data (Chapter 5) indicates that although the level of voluntary disclosure is poor in the annual reports, most of the firms disclose a high level of information regarding mandatory corporate governance requirements. Therefore, in order to explore the matter more deeply, a subsequent question was asked. The opinion of interview participants

was sought on how they would define ‘good disclosure’ in an annual report. The discussion of the response to this question is outlined in the following section.

### **6.1.4 Good Disclosure Means Mandatory Disclosure**

The respondents were further questioned about corporate governance disclosure in annual reports. The respondents from politically connected firms explained that the minimum regulatory requirements relating to corporate governance disclosure are provided in the *Code of Corporate Governance (2002)* and complying with those requirements fulfils the information needs of the users of the annual reports. However, the respondents from non-connected firms asserted that good disclosure includes the provision of mandatory as well as voluntary information. Table 6.4 summarises quotes from some of the respondents from the listed companies in this regard. The third column of the table provides the evidence while the last column provides the researcher’s interpretation of the evidence provided.

Table 6.4: Good Disclosure means Mandatory Disclosure

Nature of the Firm	Firm	Examples	Good disclosure is:
Politically Connected Companies	Textile – H (Company Secretary)	<i>'Disclosures mentioned in an annual report should be to the point. You should not mention anything beyond that.'</i>	Mandatory
	Textile B – (Company Secretary)	<i>'The pattern of the report is pre-determined in the law. There is a minimum requirement in the law and this must be reported.'</i>	Mandatory
	Sugar J – (CFO)	<i>'The good annual report can be explained as the report in which information on all the mandatory requirements is provided.'</i>	Mandatory
Non-Connected Companies	Textile C – (GM – Finance)	<i>'Good disclosure is...it would be that annual report which clearly discloses all aspect of information (voluntary and mandatory).'</i>	Mandatory + Voluntary

Table 6.4: Good Disclosure means Mandatory Disclosure

Nature of the Firm	Firm	Examples	Good disclosure is:
	Sugar – D (Deputy Financial Controller)	<i>'Good quality disclosure is very compact disclosure in the shape of points... you should use small heading, small paragraphs and... you must specify a target. The more information you add on... industry analysis that what is the overall progress of the industry... most relevant information for an investor... that his investment is not in loss.'</i>	Mandatory + Voluntary + Presentation and Layout of Annual Report
	Textile – G (Director– Finance)	<i>'There are certain requirements of corporate governance and disclosures but they go beyond that.'</i>	Mandatory + Voluntary



As Table 6.4 indicates, there is a noticeable difference in the opinions of the respondents from politically connected and non-connected firms. The data suggest that politically connected firms consider that good disclosure involves the provision of mandatory information in the annual reports. However, representatives from non-connected firms stressed that good disclosure goes beyond the provision of mandatory information in annual reports.

The reasons for this difference in the responses of politically connected and non-connected firms might be traced back to the earlier analysis carried out in Section 5.1.2. It was found in Section 5.1.2 that politically connected firms neither provided information regarding corporate governance training attended by the members of the boards nor did they explain the reasons for non-compliance with this requirement. It might thus be inferred that as politically connected members of the board do not attend corporate governance training, they are unaware about the benefits of better disclosure and provision of corporate information. Therefore, they consider compliance with minimum mandatory requirements to be a benchmark for ‘good’ disclosure. Furthermore, as explained in Section 6.2.4 below, politically connected members of the board make rational calculations about the benefits of disclosing information and do not consider voluntary disclosure to be a useful practice because it doesn’t provide them any direct benefit. Rather, disclosure of additional information may become problematic being that it may draw the undesirable attention of regulatory and tax authorities.

The results support the findings from the content analysis of the annual reports (Chapter 5), whereby a high level of mandatory disclosure was observed in the annual reports of all the companies. In contrast the level of voluntary

disclosure, although not good in all of the firms, was higher in non-connected when compared with politically connected firms. Mandatory disclosure, however, does not represent a deliberate flow of information from the listed companies.

The prior literature argues that strict monitoring improves the level of compliance with the mandatory disclosure regulation in listed companies (Owusu-Ansah and Yeoh, 2005). Therefore, the high level of mandatory disclosure in politically connected firms might not be an indicator of their inclination towards disclosure of that information. Instead, it might be the result of strict monitoring by regulatory bodies. The following section analyses participants' responses regarding the level of monitoring by regulatory bodies.

### **6.1.5 Mandatory Disclosure – Monitoring and Compliance**

The Securities and Exchange Commission of Pakistan (SECP) is the regulator of the corporate sector in Pakistan. The SECP prescribes reporting and disclosure regulations in the country. These regulations are built upon the recommendations of the Institute of Chartered Accountants of Pakistan (ICAP). The corporate governance regulations have been made a part of the listing regulations of all the stock exchanges in Pakistan. Stock exchanges in Pakistan have play the role of front line regulator (Karachi Stock Exchange, 2013).

All of the participants insisted that companies in Pakistan comply with mandatory disclosure requirements. The respondents were of the view that regulatory bodies, particularly the SECP, strictly monitor the level of compliance with the mandatory disclosure requirements.

Furthermore, in order to ensure strict compliance with corporate governance disclosure regulations, the SECP requires that the directors of all the listed companies provide a statement of compliance with corporate governance as a part of their annual reports. In addition to this statement, the external auditors of the listed companies are also required to issue a review report on the statement of compliance with corporate governance. Thus listed companies operate in a strictly monitored environment regarding corporate governance disclosures. They are left with no choice but to disclose. There follow some of the responses from the participants.

*In Pakistan, we have a good regulatory environment...we have a strict reporting requirement that is been monitored by Securities and Exchange Commission of Pakistan and certain professional bodies (audit firms).*

(C, GM Finance, Textile Sector Company)

*Mandatory disclosures are mandatory, if they don't give that then auditors qualify the report...then auditors don't even give you the report and say that you are not complying.*

(D, Deputy Financial Controller, Textile Sector Company)

These arguments support the findings of the existing literature whereby it is argued that strict enforcement by regulatory bodies results in better mandatory disclosure (Owusu-Ansah and Yeoh, 2005). Therefore, the companies provide high mandatory disclosure in their annual reports.

The findings from the interview data supported the results of the content analysis (Chapter 5), being that the level of mandatory disclosure in the annual

reports of the listed companies is significantly higher when compared with voluntary disclosure. Agency theory implies that firms increase disclosure to avoid potential pressures from regulatory authorities; therefore, these findings support an agency theory perspective. Corporate governance disclosure mechanisms have been introduced to minimise the information asymmetry between firm management and the shareholders (Healy and Palepu, 2001).

The research undertaken hence provides evidence that, in the absence of a monitoring mechanism (voluntary corporate governance disclosure), the management (agent) does not disclose information voluntarily to the shareholders (principal). In addition to agency theory, these findings also support the propositions drawn from rational choice institutionalism. It can be inferred that the management of the listed companies makes strategic calculations about the strict regulatory environment and they make the rational decision of providing 'good' mandatory disclosure. The discussion about the prevailing level of voluntary and mandatory information during the interviews gave evidence to indicate that the companies were disclosing information only to meet minimum regulatory requirements. The respondents were questioned about the reasons underlying this reluctance towards disclosure. They were further enquired about their unwillingness to disclose over and above the minimum benchmark. The following section discusses their responses.

#### **6.1.6 Drivers Underlying Reluctance to Corporate Governance Disclosure**

The International Finance Corporation conducted a survey on corporate governance practices in Pakistan in 2007. The findings of the survey indicate that business enterprises in Pakistan are reluctant to disclose information regarding corporate governance, ownership structures and operating results

(International Finance Corporation, 2007). The analysis of data in this research (Table 6.5) supports the findings of this survey.

All of the interview participants expressed their unwillingness to disclose corporate information. They openly expressed the opinion that companies did not want to disclose more information and explained various reasons for this reluctance. They stated that they were complying with regulation as was legally required, but they were not keen to disclose information. Table 6.5 provides the summary of the respondents' replies.

Table 6.5: Reluctance to Disclose

Nature of the Firm	Firm	Examples	Reasons for Reluctance
Politically Connected Companies	Sugar – J (Chief Financial Officer)	<i>‘There is a small hurdle in it...and that is that some businessmen are not willing to provide information as they have some problems with other laws...In Pakistan the greatest fear of the businessman is from tax authorities. It’s not so in Pakistan only, it’s the same all around the world...there are so many heavy taxes.’</i>	Tax authorities
	Textile – A (Company secretary)	<i>‘These (disclosure) requirements are a little bit impractical, because these are not cost effective.’</i>	Cost of compliance
	Sugar – H (Company Secretary)	<i>‘This increases paper work...for example, if ten employees were working previously, you have to add one more to complete the financial statements; this will increase your expenses. So this is little bit more costly.’</i>	Cost of compliance

Table 6.5: Reluctance to Disclose

Nature of the Firm	Firm	Examples	Reasons for Reluctance
Non-Connected Companies	Textile – K (Manager Finance, Accounts and Taxation)	<i>'In reality if you check the data in FBR30 more than one thousand MNA31s and MPA32s do not disclose their income and wealth tax. They hide their information. In personal capacity they are not showing the actual tax picture. And if they are director of a company they will do the same.'</i>	Taxation
	Textile – G (Director Finance)	<i>'Look, if the company is not politically connected, companies do like disclosing information. But in controlled... as... some of the unit that has been 75% to 80% controlled by the families, and 2 % publically control. So they are not interested to properly disclose their information.'</i>	Family Ownership

<sup>30</sup>FBR stands for the Federal Board of Revenue. The Federal Board of Revenue is responsible for formation and enforcement of fiscal laws and collection of revenue for the government of Pakistan.

<sup>31</sup>MNA stands for Member of National Assembly in Pakistan.

<sup>32</sup>MPA stands for Member of Provincial Assembly in Pakistan.

Table 6.5: Reluctance to Disclose

Nature of the Firm	Firm	Examples	Reasons for Reluctance
	Textile – F (Chief Financial Officer)	<i>'I have told you here the majority of the businesses are family owned and the reports being made in respect of these regulations are just to meet the legal requirement.'</i>	Family Business
	Sugar – I (Chief Financial Officer)	<i>'Actual culture is the same...that most of the businesses are family oriented businesses...and due to that factor... it is family oriented business so they... people think that listing is of no use and when they think that it is a family owned business, then they don't want to disclose the information as well...the only thing that makes difference...if the companies are closely held, then they will definitely not provide additional information because they do not want to provide.'</i>	Family Ownership



Table 6.5: Reluctance to Disclose

Nature of the Firm	Firm	Examples	Reasons for Reluctance
Regulator	COO33 – Stock Exchange	<i>'The corporate community as a whole has not accepted...it has been imposed upon them, they have to implement it... they are resisting over it...'</i>	Family ownership
Statutory Audit Firm	Q – Partner	<i>'People normally hesitate....they think that if we give information....something undesirable will happen...tax authorities will start following us.'</i>	Tax authorities

<sup>33</sup> Chief Operating Officer

The examples in Table 6.5 clearly indicate that the companies are reluctant to disclose information. The respondent from the statutory audit firm also suggested that most companies disclose the bare minimum of information and hardly comply with mandatory requirements. However, it might also be observed that the reasons for this reluctance vary amongst the various groups of respondents.

The respondents from the politically connected firms explained that information disclosure is avoided because it leads to difficulties in subsequent dealing with various government departments. Respondent J explained that disclosure of financial information is especially problematic, as tax authorities raise queries about the profitability position of the company. Non-financial disclosures are also avoided, being that the information can be cross-matched against other data and it becomes difficult for the management to defend any contradictions. The most unexpected response came from respondent J, a CFO in a politically connected firm who asserted:

*If you would pay the tax with 100% honesty, then you cannot do business. It's my personal view, that you cannot do business in that case.*

However, the following response was one of the most unexpected statements from one of the respondents from the politically connected firms:

*Companies do not declare the profit. First thing is if the company will show the profit then the company would have to declare dividend. Secondly, if the company will show the profit then it would have to pay the tax.*

The respondents from non-connected firms argued that politically connected companies do not provide fair financial disclosures as they evade taxes. They insisted that while politically connected firms are not making actual losses, they most often declare losses in their annual reports. When the annual reports of politically connected firms from the sugar and textile sectors used in this research were assessed, it was found that most of these companies showed losses from 2009–2013. Furthermore, most of the politically connected companies did not declare any dividend during the period under study. However, a considerably higher number of non-connected firms declared both profits and dividends. The analysis of annual reports in other sectors groups also provided similar results (please refer to Appendix D). These results support the existing literature, whereby it is argued that politically connected firms disclose poor accounting information and do not provide good quality information in regard to firms' unobservable economic performance (Riahi-Belkaoui, 2004; Chaney et al., 2011)

The members of politically connected companies named increased cost as a second major reason for avoiding disclosure in annual reports. Respondent A, stated:

*There is a cost of financial statements. To publish, print and design them. I mean, it also includes the cost of time, you have to allocate human resources and when you want to publish, it also adds to the cost.'*

In addition to the printing cost, the respondents also showed their concern for the cost of forming various board committees, comprised of qualified professionals. This implies that the increased cost is also a barrier to disclosure.

Moreover, it shows that politically connected firms do not consider the disclosures to be useful in terms of the flow of information to minority shareholders. Instead, the increase in costs is perceived to be negative for the firm. These findings support the earlier findings of the survey conducted by International Finance Corporation (2007), whereby research participants had expressed their unease about the costs of corporate governance regulations.

The respondents from non-politically connected firms considered that companies do not want to disclose information being that most of the companies are family owned and controlled. The stock market in Pakistan is highly concentrated, while family ownership and control is an important feature of the stock market (Hamid and Kozhich, 2007; Iqbal, 2008). Prior literature suggests that the extent of voluntary corporate governance disclosure is negatively related to the firms being owned or controlled by founding families (Chau and Gray, 2002; Ali et al., 2007). The analysis of the interview data thus provides evidence for these arguments. The most prominent reason for the unwillingness to disclose turned out to be the family control of the listed companies.

*It is generally a single family that holds a significant shareholding...that is why even if maximum information is disclosed; still it is not going to make a significant difference. As in our country the true corporate culture which is practised in some developed nations, where the basic concept of corporations is...disbursed ownership...that is not practised in our country.*

(C, GM Finance, Textile Sector Company)

Some of the respondents stated that, since the establishment of Pakistan, most of the businesses in the country had been family owned. In order to promote corporate culture in the country and to strengthen its stock exchanges, the government offered tax rebates to listed companies. Therefore, in order to take advantage of this tax benefit, family businesses listed themselves on stock exchanges. However, with the passage of time, the government has eliminated that tax relief. Therefore, listed companies have been left with very small tax incentives, while they have to comply with corporate governance regulations (Israr, 2012). As they do not receive any benefits, listed companies are therefore becoming delisted from stock exchange. One respondent from a listed company explained:

*The government announced a benefit that was tax rebate...most of the businesses were actually family oriented businesses...they wanted to maintain their family structure in the same way...but they wanted to take benefit out of it. However, over the period of time that benefit is also eliminated. If you see in the previous five to six years, how many companies have been listed in the stock exchange? Their perspective is that there is no tax benefit anymore...people think that listing is of no use and when they think that it is a family owned business, then they don't want to disclose the information as well.*

(I, Chief Financial Officer, Sugar Sector Company)

Another respondent said:

*One prime reason is...the compliance with the statutory requirement because they are family owned companies, and they*

*will definitely not wish to hire the non-executive director on their board. So, they will prefer to go for delisting. So, they offload 25% shares from their own pockets or from banks and just get rid of the minority shareholders. They will...request SECP to determine the market price based on their book value....so, may be getting back their shares at below par value....and it ensures that the legal requirements are not in fact practical.*

(B, Chief financial officer, Textile Sector Company)

Overall, the results of the analysis suggest that a severe agency conflict exists between the controlling family members on the boards of listed companies and the minority shareholders. The controlling families do not want to disclose information to the minority shareholders. This situation indicates a misalignment between the existing institutional environment in Pakistan and the regulations introduced.

The following sections focus on acquiring information regarding the influence of political connectedness on the mandatory and the voluntary disclosures of the companies.

## **6.2 The Influence of Political Connectedness on Corporate Governance Disclosures**

### **6.2.1 Political Connectedness and Mandatory Disclosure**

This section focuses on gaining insight into the second sub-question of this research project: ‘How does political connectedness influence the disclosure of mandatory corporate governance information in the annual reports of listed companies in Pakistan?’

The interview data was collected from politically connected as well as non-connected firms in the sugar and textile sectors. At the beginning of the interview process, it was expected that, owing to the sensitivity of such issues, respondents from politically connected firms might resist openly expressing their opinions, in comparison with the non-connected firms. However, as the interviews were conducted, the respondents from connected firms openly provided opinions on how politicians influence business. The respondents from the politically connected firms also explained various ways in which these firms perform such corruption-oriented activities, such as window dressing, tax evasion, under/over invoicing, etc. Political corruption is pervasive in Pakistan. In 2012, Pakistan was ranked as the twenty-eighth most corrupt country on the Transparency International Corruption Perception Index (2014).

Although there is a lack of literature on the influence of political connectedness on corporate governance disclosures, the prior literature has found that political influence is negatively related to corporate disclosure and transparency<sup>34</sup>, accountability and quality of accounting information and positively related to earnings opacity<sup>35</sup> in annual reports (Bushman et al., 2004; Riahi-Belkaoui, 2004; Chaney et al., 2011). In contrast, the analysis of the interview data suggests that political influence does not affect mandatory corporate governance disclosures. Table 6.6 below summarises responses from the interview participants in this regard.

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<sup>34</sup>Bushman et al. (2004, p. 208) defined corporate transparency as the availability of firm specific information to company outsiders.

<sup>35</sup>Riahi-Belkaoui (2004) defined earnings' opacity as a measure reflecting the insufficiency of disclosed information regarding a firm's true but unobservable economic performance.

Table 6.6: Political Connected Firms and Mandatory Disclosure

Nature of the Firm	Firm	Examples	Will they Disclose?	Reason for Disclosure
Politically Connected Companies	Textile – A (Company secretary)	<i>'Reporting requirements, he (politician) can't influence them...because they (SECP) are tough guys and...they like law enforcement. Yes, because they hardly get influenced.'</i>	Yes	Strict enforcement
	Sugar – J (Chief Financial Officer)	<i>'They will disclose...if they would not then legal authorities will make them comply with the law.'</i>	Yes	Strict enforcement
	Textile B – (Company secretary)	<i>'They will have to disclose mandatory information. Otherwise they will get notices from the SECP and the stock exchange.'</i>	Yes	Strict enforcement
Non-connected Companies	Textile C – (GM Finance)	<i>'Politicians cannot influence...because that is directly monitored by the regulatory bodies, and there is a strict enforcement for this area.'</i>	Yes	Strict enforcement
	Textile – E (CEO)	<i>'They will disclose what is required by law...whatever is the'</i>	Yes	Strict



Table 6.6: Political Connected Firms and Mandatory Disclosure

Nature of the Firm	Firm	Examples	Will they Disclose?	Reason for Disclosure
	and Chairman)	<i>requirement, they disclose.'</i>		<i>enforcement</i>
	Sugar – H (Company secretary)	<i>'They only share information which needs to be shared.'</i>	Yes	<i>Strict enforcement</i>
Regulator	R – Regulator	<i>'Obviously the powerful people in Pakistan...make their laws, they can twist the regulation, and they can give the regulation their own meaning and they can implement according to their own standings. The things are not very simple in Pakistan.'</i>	No	<i>No Influence</i>
Statutory Audit Firm	Audit Firm – L (Partner)	<i>'As far as disclosure requirements are concerned, these politicians may not have any influence.'</i>	Yes	<i>Strict enforcement</i>

Table 6.6 indicates a strong agreement in the views of all participants, except for regulator R. All respondents asserted that politically connected firms have to abide by the mandatory corporate governance disclosure regulation because the SECP strictly monitors compliance. It can be inferred from this evidence that political connectedness does not influence regulation implementation. The respondents were of the view that politicians exercise a profound influence over policy making. Therefore, policy making in those industries with substantial participation from politicians is heavily influenced.

In addition to policy making, politically connected firms obtain administrative benefits from various government departments. They can easily obtain access to utilities and support from government bureaucracy, always ready to resolve their administrative problems. However, when it comes to the enforcement of corporate governance regulation, politically connected firms comply. For example, a respondent from a non-connected firm said:

*Reporting is being done as per the minimum requirement of the Code of Corporate Governance no matter if the firm is political or non-political.*

(I, Chief Financial Officer, Sugar Sector Company)

However, the respondents also explained the reasons for the disclosure of mandatory information. First of all, the respondents said that regulation enforcement in the country is quite strict. Most of the respondents were of the view that, in case of non-compliance, the SECP sends notices to everyone, irrespective of their political affiliation. While it may not take any further legal action immediately, as soon as the politician loses power then the regulatory authorities take action against him. Therefore, most of the people prefer to

comply with regulations. The Chief Financial Officer of a politically connected firm claimed that

*If you are politically strong today and you are not fulfilling the paperwork and legal requirements, and the legal authority is not asking you anything because of political influence at the moment, but after five years you will be answerable. Your record is maintained by the regulatory authority, your history is being made...it means you will be accountable at later stage.*

(J, Chief financial officer, Sugar Sector Company)

The respondent from a non-connected firm also shared similar views:

*In the implementation of rules and regulation, during the time that person holds a political position, he may not follow the rules and regulations. However, later on...subsequently...when their tenure ends...government and bureaucracy now documents everything...they have become very active now...then they use it against such politician.*

(I, Chief Financial Officer, Sugar Sector Company)

The above evidence indicates that political connectedness does not influence mandatory corporate governance disclosures in the annual reports. These results support the earlier findings of content analysis in Chapter 5, demonstrating the level of mandatory disclosure in both connected and non-connected firms was high. However, on the whole, the level of disclosure in non-connected firms was higher than in connected firms.

These results provide support for the perspectives of agency theory as well as rational choice institutionalism, whereby disclosure regulations serve as a monitoring corporate governance mechanism to resolve agency conflict between the principal (management) and the agent (minority shareholders). Furthermore, based on their calculations about the strict regulatory environment prevailing in the country, the directors of politically connected firms decide strategically to comply with corporate governance and disclosure regulation, which results in provision of high mandatory disclosure.

These findings support the findings of Khemakhem and Dicko (2013) who argue that politically connected listed companies comply with mandatory provisions because non-compliance results in penalties being applied. However, the response from the respondent R (representative of regulatory body), suggests that politically connected people could use their power to influence the regulation formation and its implementation. The following section provides a detailed account of the in-depth analysis that was carried out in consideration of respondent R's opinion.

### **6.2.2 Political Connectedness and Truth and Fairness of Mandatory Disclosures**

The assessment of the transparency of corporate governance disclosure does not come under the scope of this research. However, in Table 6.6 above, it can be seen that the response from respondent R, who was working at a key position in a regulatory organisation, was quite surprising. Respondent R stated that politicians always find ways of influencing policy making and its implementation. His response was an indication of the potential problems in the existing disclosure practices of politically connected companies.

As interview transcripts from all the participants were read iteratively, an unsettling theme emerged in regard to the truth and fairness of the disclosures provided by politically connected firms. It was found that, although these firms provide most of the mandatory disclosures in annual reports, their reliability might not be certain. Several respondents explained that corporate governance disclosure regulation is followed only in documents, while corporate governance is not practiced in reality - meaning in true practice. The partner of a statutory audit firm made this claim about the disclosure practices of politically connected firms:

*Practically, it (corporate governance regulation) remains just a piece of document...only for the purposes of attestation, practically it was not implemented.*

(O, Partner, Statutory Audit Firm)

The partner of another audit firm stated:

*In Pakistan there are many things which are written in the books but nothing is done in practice.*

(L, Partner, Statutory Audit Firm)

Another statement emerged from the representative of another regulatory body:

*They disclose but don't implement.*

(S, Regulator)

Several representatives from the listed companies also agreed upon this in the context of politically connected firms; for example:

*In annual reports they show and in practice they do not comply.*

(K, Manager Accounts, Finance and Taxation, Textile Sector Company)

In order to look deeper into this matter, the review report on compliance with the best practices of corporate governance was analysed in each of the 200 annual reports of the listed companies used for this research. In the 100 annual reports of non-connected firms, it was found that statutory auditors had only reported only one instance of non-compliance in the review report. However, in the 100 annual reports of politically connected companies, 16 such instances were found where the statutory auditors were of an opinion that they could not objectively verify the statement of compliance provided. Thus, they may not appropriately reflect the company's compliance with the *Code*. This evidence leads to the conclusion that politically connected firms provide corporate governance disclosures in the annual reports to meet minimum regulatory requirements. However, the information provided may not be transparent.

Earlier literature on financial transparency has found that political influence is negatively related to corporate disclosure and transparency, earnings opacity, accountability and quality of accounting information in annual reports (Bushman et al., 2004; Riahi-Belkaoui, 2004; Chaney et al., 2011). However, there is a dearth of literature on the influence of political connectedness on the transparency of corporate governance disclosure, indicating the need to carry out future research whereby the transparency of corporate governance information in politically connected firms may be analysed.

The following section will discuss the findings of the interview data analysis regarding the impact of political connectedness on voluntary disclosures.

### **6.2.3 Political Connectedness and Voluntary Disclosure**

This section focuses on acquiring information and insights into the third sub-question of this research: ‘How does political connectedness influence the disclosure of voluntary corporate governance information in the annual reports of listed companies in Pakistan?’

There is a scarcity of literature addressing the impact of political connectedness on voluntary disclosure practices of the firms. However, as has been mentioned earlier, the literature suggests that political connectedness has a negative impact on the disclosure of financial and accounting information in annual reports (Riahi-Belkaoui, 2004; Chaney et al., 2011). The results from the content analysis in this research suggest that voluntary disclosure is poor in the annual reports of politically connected firms. The following table provides the responses of some of the research participants regarding voluntary disclosure in the annual reports of politically connected firms.

Table 6.7: Political Connectedness and Voluntary Corporate Governance Disclosure

Nature of the Firm	Firm	Examples	Do politically connected firms disclose voluntarily?
Politically Connected Companies	Textile – A (Company secretary)	<i>‘Whether it is a politician who is doing business, you can consider him to be a businessman only, instead of a politician. Every businessman conceals many things...if they are doing any good social work, they can disclose it a little bit.’</i>	No
	Textile B – (Company secretary)	<i>‘The politically connected people will not prefer this (voluntary disclosure). They will simply print a booklet to comply with the requirements.’</i>	No
	Textile – J (CFO)	<i>‘Not only the political people but everyone – political or non-political; no-one likes to disclose any information.’</i>	No
Non-connected Companies	Textile – D (Deputy Financial Controller)	<i>‘For political people, the most important concern is to save their political career, so if you share more information, more questions will be raised.’</i>	No
	Textile – G (Director Finance)	<i>‘If the company is not politically connected, companies do like disclosing information.’</i>	No
	Sugar – I (Chief Financial Officer)	<i>‘As far as information of politically connected firm is concerned, they only fulfil minimum requirements.’</i>	No



The responses in Table 6.7 indicate that the interviewees from connected as well as non-connected firms both agreed that politically connected firms do not provide voluntary corporate governance disclosures in the annual reports. The respondents from politically connected firms insisted that no company wants to disclose voluntary information, regardless of its political connections. However, respondents from non-connected firms stressed that provision of excessive information was avoided by politically connected firms because politically connected firms find it difficult to handle the disclosure of additional information. This implies that politically connected firms are hesitant to disclose openly information on their governance related activities as they feel afraid of subsequent questions or objections. This finding supports the initial propositions of this research.

### **6.2.4 Voluntary Disclosure is Not Useful**

One interesting theme that emerged in the analysis of interview data was that the respondents insisted that disclosure of voluntary information was not useful. The most striking response emerged from respondent H, a company secretary in a politically connected sugar sector company, who asserted that the disclosure requirements set out by regulations are the maximum standards for compliance, and that no information should be provided over and above those requirements. When he was asked about the provision of information over and above mandatory requirements, he replied:

*We cannot cross the limits... disclosures mentioned in an annual report should be to the point'*

(H, Company Secretary, Sugar Sector Company)

The following two statements from the representatives of politically connected firms also emphasise the fact that the respondents consider that information regarding corporate affairs is owned by the company management and its disclosure is not useful, unless required by regulation.

*Neither I nor anyone else would like to disclose the (voluntary) information. It is my right, why should I tell everything to the public about anything? Until or unless it is the requirement, I would not disclose anything.*

(J, Chief Financial Officer, Sugar Sector Company)

As per the traditional agency theory perspective, company management tends to be self-interested and opportunist and will tend to hold information for their own personal benefits (Healy and Palepu, 2001). The responses by interviewees in this study strongly support the assumption of self-interest. The usefulness of disclosures is also directly related to the self-interest of management and directors, and not to the interest of shareholders. The interviews revealed that there was no sense of fiduciary duties towards the information requirements of minority shareholders. Therefore, a severe agency problem existed between the board members of these family-controlled politically connected companies and the minority shareholders. For example, participant J stressed:

*I do not want to disclose because it doesn't benefit me in any way.  
There is no benefit to me for disclosing more information.*

(J, Chief Financial Officer, Sugar Sector Company)

The respondents from politically connected, as well as non-connected companies, openly expressed how the members of the board in politically connected companies expropriate money and take other undue benefits from the business. Respondent B, a company secretary from a politically connected company stated:

*I know so many people in the business...they are taking money from business...there are a number of ways... they get money from sales. They have decided underlying side contracts with the buyers, they under-invoice on procurements. At the end of the day the company is not making money, they will not get benefit, they will not get dividend. The money goes into their pocket, and it is not disclosed. Their private accounts maybe in Switzerland, maybe in any other country, maybe in Dubai. Even statutory and regulatory authorities don't know about it. They will not...they can't track it.*

Respondent Q, a partner of an audit firm, also shared his experience with a politically connected firm:

*They (politically connected members of the board) take some of the things for their personal use. They don't do that for company...there are many such things...that are not allowed to them...I have seen it personally...they will say, "It's ok, because it's authorised by a board member who is a minister, so it's ok." I said "It is not allowed by law, you can use company assets for business purposes only, and you cannot use them for personal." But sometimes it happens so...I had seen it in a company.*

The analysis of these research data supports the argument that politicians' involvement in company affairs (such as being members of the board) results in their bargaining with managers, whereby they offer bribes to the managers in pursuit of their political interests (Shleifer and Vishny, 1994). Thus, despite being the agents of the shareholders, politically connected members of the board work to meet their personal political interests. Thus the presence of politically connected members on boards ultimately leads to a lower level of disclosures and transparency.

In the institutional context of Pakistan, with high levels of political corruption and an under-developed capital market, it was expected that politically connected firms would provide minimum voluntary disclosure in the annual reports. These findings support the initial research propositions and the results of the content analysis (Chapter 5).

### **6.3 Findings and Conclusion**

The analysis of the interview data revealed that an accounting and finance department is mainly responsible for preparation of annual reports. It is the ultimate responsibility of the Chief Financial Officer to prepare annual accounts, compile them in the form of a report and present them to the board of directors. However, the members of the board actively guide and monitor the process of annual report preparation. The members of the board read the contents of annual reports and provide instructions for the addition or deletion of information. It was also found that politically connected firms consider annual reports as a tool for dissemination of mandatory information only. However, non-connected firms asserted that annual reports are aimed at

providing mandatory as well as voluntary and corporate governance information.

The analysis of data suggests that annual reports are mainly prepared to meet regulatory requirements. Although the level of mandatory disclosure in all of the listed companies is high, the reason for this good level of disclosure is that the Securities and Exchange Commission of Pakistan is a strict regulator and ensures compliance with regulation. However, it was found from the interviews, that politically connected firms do not provide true and fair disclosures; instead, they comply with minimum regulatory disclosure requirements regarding their corporate governance obligations.

It was found that all the listed companies in the sample avoid disclosing voluntary information in their annual reports. The pervasiveness of family ownership structure is the main reason for this reluctance to disclose in non-connected firms. The family-controlled companies explicitly expressed their unease with certain corporate governance provisions, such as, board independence and board qualifications. However, the level of unwillingness towards voluntary disclosure increases manifold in the case of politically connected firms.

It was found that the nature of agency conflict was more severe in politically connected firms because these firms avoid providing voluntary information in the annual reports. It might be inferred that a more severe form of agency conflict exists in these firms compared to non-connected firms. A lower level of disclosure might indicate that politically connected members of the board influence decisions pertaining to corporate governance disclosure, owing to the fear of cross matching the information and subsequent queries being raised. In

addition, the decisions regarding corporate governance disclosure are taken on the basis of perceived benefits and interest. However, the form of interest varies among politically connected and non-connected firms. A strong notion of self-interest was observed when the members of the board have political connections. It was also found that the decisions relating to disclosure are not driven by self-interest only. Instead, rationality plays an important role and considering strict regulatory enforcement, firms disclose mandatory information on corporate governance, while voluntary disclosures are avoided.

The analysis of interview data has provided validation of the earlier findings obtained through the analysis of annual report data. The purpose of conducting interviews was to add to the richness of the earlier analysis and to make it more robust. The results obtained from the analysis of the annual report data have been further elaborated and enhanced by the results of the analysis of the interview data. It has therefore been found that the findings from the interview data not only support the results obtained from the content analysis, but they also support the initial theoretical foundations of the research.

## **Chapter 7 Conclusion**

### **7.0 Introduction**

Chapter 2 of this thesis elaborated the institutional background for this research. Chapter 3 provided a detailed review of prior literature in the field of corporate governance and disclosures and explained the theoretical foundations of this research. The critical review of the prior literature identified the gaps and developed foundation for the conduct of this research. Chapter 4 outlined the philosophy informing this research project. Explanations were provided regarding the design of this research project and the methods used for data collection and analysis were elaborated.

Chapter 5 outlined the results obtained from the content analysis of the annual reports along with an in-depth analysis of silence on corporate governance practices in the annual report narratives of the listed companies. Chapter 6 provided results obtained from template analysis of the interview data. The results obtained from the analysis of interview data enabled triangulation and thus strengthened confidence in regard to the findings of this research.

This chapter provides the conclusions to this research project. The contributions of this research are outlined. Limitations of this study are also recognized and directions are provided for future research.

Figure 7.1 shows how Chapter 7 is positioned in the thesis.

Figure 7.1: Chapter 7 – Positioning in the Thesis

Identification of Research Gap: The Impact of Political Connectedness on Corporate Governance Disclosures in Pakistan	<b>Chapter 1 - Introduction</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Rationale</li> <li>– Personal Motivations for the Study</li> <li>– Research Objectives and Questions</li> <li>– Overview of the Thesis and Contribution to Knowledge</li> </ul>
	<b>Chapter 2 – The Institutional Background</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Background to the Study</li> <li>– The Institutional Framework in Pakistan</li> <li>– Capital Market</li> <li>– Corporate Governance and Reporting Regulations</li> <li>– Pakistan's Institutional Context: Relevance to Other Developing Countries</li> <li>– Conclusion</li> </ul>
	<b>Chapter 3 – Literature Review</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Political Connectedness</li> <li>– Political Connectedness in Developing Countries</li> <li>– Corporate Governance and Disclosure Practices</li> <li>– Political Influence and Corporate Disclosure</li> <li>– Corporate Governance and its Disclosure: Theoretical Underpinnings</li> <li>– Identification of Research Gaps</li> <li>– Contributions of this Research – Addressing the Existing Gaps</li> <li>– Conclusion</li> </ul>
Methodology Selection	<b>Chapter 4 – Research Methodology, Design and Methods</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Research Philosophy, Research Approach and Research Design</li> <li>– Data Collection Methods</li> <li>– Data Analysis</li> <li>– Ethical considerations</li> <li>– Conclusion</li> </ul>
Analysis and Discussion of Findings	<b>Chapter 5 – Interpreting the Annual Report Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Qualitative Content Analysis</li> <li>– Analysis of Silence in Annual Reports</li> <li>– Conclusion</li> </ul>
	<b>Chapter 6 – Interpreting Interview Data</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– How do Companies in Pakistan Disclose Information in Annual Reports?</li> <li>– The influence of Political Connectedness on Corporate Governance Disclosures</li> <li>– Conclusion</li> </ul>
Findings and Conclusion	<b>Chapter 7 - Conclusions</b> <ul style="list-style-type: none"> <li>– Introduction</li> <li>– Findings of the Research</li> <li>– Contributions to Knowledge</li> <li>– Quality of Research</li> <li>– Limitations of the Study and Directions for Future Research</li> </ul>



This chapter is structured as follows. Section 7.1 of this chapter summarises the main findings of this research along with an explanation of how the results obtained answered research questions. Section 7.2 explains how this research has contributed to knowledge in the field of corporate governance. Section 7.3 explains that the research was carried out ensuring the best quality standards in regard to the various criteria outlined by researchers. Section 7.4 outlines various limitations associated with this research along with an elaboration of potential directions for future research.

### **7.1 Findings of the Research**

The main findings from the research carried out in this study attest to and validate that politically connected members of the board are self-interested and opportunistic, and make rational decisions regarding corporate governance disclosure. Politically connected companies take into consideration the institutional factors, such as the regulatory environment, while making decisions. However, this research has also found that the self-interest and benefits are not always monetary in nature. For example, the members of the board demonstrate the shirking of their fiduciary duties by not increasing the level of their qualifications to perform their roles more effectively. Instead, they comply for the sake of complying in terms of corporate governance practices, thus paying ‘lip service’ to the requirements. These findings are consistent with the argument that not all forms of corruption are monetary in nature (Andersson and Heywood, 2009). Owing to a strict regulatory environment, politically connected firms provide good mandatory corporate governance disclosures. However, the transparency of the disclosure provided may be doubtful.

This research used two different sources of data; namely, audited annual reports and semi-structured interviews. Three different methods were used for analysis of data: qualitative content analysis, analysis of silence and template analysis. The use of multiple data sources and data analysis methods enabled the researcher to validate the findings of the research through triangulation. A summary of the results of this research so follows, in reference to each research question.

***Question 1: How do listed companies in Pakistan disclose corporate governance related information in annual reports?***

This research question focused on exploring the process of preparation of annual reports to enable understanding of the role of the board in the process of decision-making regarding corporate governance disclosure. The research question also helped in examining the voluntary and mandatory disclosure practices of listed companies across the sugar, textile and the several sectors group. Template analysis (Chapter 6) showed that that board of directors are actively involved in the preparation of annual reports in the listed companies of Pakistan. Although, the annual reports are primarily prepared by the accounting and finance department, the members of the board actively guide and monitor the process. However, the purpose of preparation of annual reports is to meet regulatory requirement regarding preparation and dissemination of financial statements. No significant meaning or importance is attributed to non-financial data and corporate governance disclosures.

The results of the qualitative content analysis of audited annual reports (Chapter 5) revealed that there are noteworthy differences between the levels of voluntary and mandatory disclosures in the annual reports. In both the sugar

and textile sectors, companies provide an adequate level of mandatory disclosure. However, the level of voluntary disclosure is poor in both industries. The use of triangulation strengthened the results obtained because the analysis of interview data supported the findings of qualitative content analysis. The respondents further asserted that it is not useful to provide information which is not required by the regulator (voluntary information).

It was found that, in the context of Pakistan, 'good' disclosure is mandatory disclosure. It was also found that most of the companies studied in this research comply with mandatory corporate governance disclosure requirements. The analysis of interview data revealed that there was a clear resistance towards provision of information in annual reports. The companies provided this information only because it was required by law and they did not have any choice about non-disclosure. Furthermore, it was found that family ownership and the fear of tax authorities were the main factors responsible for this reluctance towards disclosure.

No significant variation was observed in the level of disclosure across the different sectors. Instead, there was a similarity in trends of disclosure in various corporate governance constructs in the industries studied. It was found that the firms in all the sectors provided minimum disclosure regarding the profile of the board, while maximum disclosure was provided regarding board accountability.

***Question 2: How does political connectedness influence the disclosure of mandatory corporate governance information in the annual reports of listed companies in Pakistan?***

This research question focused on exploring the differences in the mandatory corporate governance disclosure practices of politically connected and non-connected firms. It also aimed to explore in depth the underlying motivations and processes through which political influence is transmitted to affect mandatory disclosure. The use of qualitative content analysis revealed that the level of disclosure was adequate in both politically connected and non-connected firms, with politically non-connected firms achieving slightly better levels of disclosure. However, the level of disclosure on the construct of profile was noticeably poor in politically connected firms.

The analysis of interview data revealed that politically connected firms disclose mandatory corporate governance information, owing to strict regulatory enforcement. Template analysis indicated that even if the authorities do not take legal action for non-compliance against a politician immediately after the incidence of non-compliance is observed, they certainly take action as soon as the politician loses power.

Another important finding indicated that despite the threat of penalisation from regulatory bodies, politically connected firms did not disclose information on the corporate governance trainings and qualifications of the members of the board. Thus, these firms faced the threat of monetary penalties, but did not provide information on board profile. One of the reasons for this non-disclosure might be found in the argument that qualifications held by

politicians are an important issue in the Pakistan's political context and their disclosure can have political consequences for the politicians.

These findings support the theoretical propositions of agency theory and rational choice institutionalism. It might be concluded that politically connected members of the board demonstrate self-interested and opportunistic behaviour. As evidenced by the interview data, they make strategic calculations about the strict regulatory environment and make the rational decision of disclosing mandatory information. However, as these members of board are not well qualified and competent, they do not provide information about their profile in the annual reports. The companies face the risk of penalty and monetary loss by non-disclosure of this information. However, politically connected members of the board neither improve their qualifications, nor do they provide disclosure. This may indicate the prevalence of a form of political corruption which is not monetary in nature.

These findings challenge the notion that self-interest and utility can always be calculated in monetary terms. Instead, self-interest and opportunism of the members of politically connected firms motivates them to stay unqualified and thus expropriate minority shareholder interests through shirking. The chances of being penalised and thus facing a financial loss also fail to convince them for improving their knowledge and skills, as required.

Template analysis also indicated that although the level of mandatory disclosure in the annual reports was high; however, the reliability of disclosures was not certain. The analysis of interview data indicated that mandatory corporate governance disclosures in the annual reports of politically connected firms might not be transparent as they are often provided for

meeting regulatory criteria only. The analysis of annual report data supported this finding as, in several instances, the statutory auditors of politically connected firms had refrained from objective verification of corporate governance disclosures provided in those annual reports.

***Question 3: How does political connectedness influence the disclosure of voluntary corporate governance information in the annual reports of listed companies in Pakistan?***

The qualitative content analysis of data (Chapter 5) in the annual reports of listed companies revealed that politically connected companies disclose a visibly lower level of voluntary corporate governance information in comparison to non-connected firms. Meanwhile, non-connected firms provide better disclosure on all the constructs of corporate governance. The analysis of silence in the annual reports (Chapter 5) also attests to this finding of the qualitative content analysis, as a strong evidence of silence and empty speech on corporate governance matters was found in the annual reports of politically connected firms.

The analysis of silence indicated that the annual reports of non-connected firms provided detailed disclosure and covered a broad range of corporate governance aspects. It was found that non connected firms provided detailed information about their accountability regarding shareholder value creation, strategic decision making and disclosure. These companies outlined their past, present and future strategies for dealing with challenges in corporate environment. These companies also provided details about the outcomes of past company strategy.

In addition, non-connected companies also expressed their strong commitment towards the provision of timely, reliable and transparent corporate disclosure. Furthermore, non-connected firms provided detailed information about the roles and responsibilities of the directors. However, the annual reports of politically connected firms stayed silent on all these aspects of disclosure. The analysis of silence revealed that disclosure in the annual reports of politically connected firms is mainly superficial, inadequate, covering a limited range of issues and lacking depth. Evidence of empty speech was also observed regarding disclosure on board independence.

A template analysis of interview data (Chapter 6) revealed that politically connected firms did not consider provision of voluntary disclosure to be *useful*. A complete lack of fiduciary duties was observed as politically connected firms insisted on providing minimum information, claiming that the public was not supposed to be informed of anything about the company beyond legal requirements. Strong evidence was found in support of the research project's theoretical propositions as the notion of self-interest and opportunism was reinforced. The representatives of politically connected firms claimed that they do not disclose corporate governance information as it does not benefit them. Some of the respondents explicitly stated that they did not want to disclose information as they were involved in rent seeking activities. Evidence obtained from representatives of audit firms also confirmed the involvement of politically connected members of the board in rent seeking activities, which resulted in poor level of disclosure.

The findings from the analysis of data support the initial theoretical propositions of the research based on agency theory and rational choice

institutionalism. It might be argued that these theoretical perspectives provide useful explanations regarding corporate governance phenomena in the context of developing countries like Pakistan. However, the findings of the research also indicate a need for further theoretical development and expansion in the field.

## **7.2 Contributions to Knowledge**

1) The research findings indicate that politically connected members of the board are self-interested individuals, although the institutional environment plays an important role in shaping their behaviour. For example, fearing regulatory actions, they provide a high level of mandatory information. The strict regulatory environment forces them to comply. These findings support the presence of a strong agency conflict in the context of Pakistan.

2) This research has reconciled the economic agency perspective with an institutional perspective. The evidence supports the use of a socialised version of agency theory as it was argued that outcomes cannot always be economically calculated. This study also supports the calls for more in-depth research, using multiple theoretical lenses and combinations of various research methods in corporate governance and disclosure literature.

3) This research has filled a gap in existing corporate governance literature in developing countries being that no prior research has, to the best of the researcher's knowledge, investigated the impact of political connectedness on corporate governance disclosure. It is to be argued that although several studies have investigated the impact of political connectedness on the quality of financial reporting, there are currently no studies investigating the impact of



political connectedness on non-financial information, such as the corporate governance disclosure practices of listed companies.

4) This research has explored the process of formation of annual reports in the real life context of a developing country that is Pakistan. The research indicates that members of the board take decisions regarding the nature, level and quality of corporate governance disclosure. The research also indicates that statutory audit firms participate in the preparation of financial statements, which is a violation of the International Financial Reporting Standards.

5) This research has made an important methodological contribution because it has analysed the narrative sections of the annual reports through an examination of silence in regard to corporate governance information. Although the analysis of silence has been used for the study of political communication, it has not been widely used as a tool for analysis of annual report data. This research has utilised analysis of silence in conjunction with the qualitative content analysis in order to seek deeper insights. The method employed here indicates that politically connected firms use silence and empty speech as tools for non-disclosure.

### ***Theoretical Implications***

Existing research in the field of corporate governance and disclosure has predominantly utilised the agency theory perspective for conducting quantitative investigation. This research project was a response to the calls for investigation of agency conflict in rich contexts (Eisenhardt, 1989; Heracleous, 2008; Heracleous and Lan, 2012). As many researchers have proposed using agency theory in combination with other theoretical perspectives so as to capture effectively the complexity of the phenomena researched (Eisenhardt,

1989; Cohen et al., 2008), for the purpose of gaining deep insights, this research used the agency theory perspective in conjunction with rational choice institutionalism. This research is significant academically being that it has combined the theoretical underpinnings of agency theory and institutional theory. It is argued that both perspectives, if utilised together, jointly provide a better and more robust understanding of complex real life phenomena.

Initial research propositions were developed for the purpose of directing the scope of the future research. It was intended to analyse the so called *positivist* and *rigid* assumption of self-interest in the institutional context in which social actors make disclosure decisions. Various recent debates and suggestions regarding an institutionally sensitive version of agency theory were taken into consideration while analysing data (Hendry, 2005; Heracleous and Lan, 2012; Wiseman et al., 2012). Through an analysis of voluntary and mandatory disclosure practices of politically connected firms in Chapter 5 and Chapter 6, the notion of self-interest, opportunism and rational decision making have been verified. However, it has also been found that institutional (regulatory and political) environment plays an important role in influencing disclosure decisions.

The empirical analysis of annual report data has enabled the researcher to look for an explanation beyond the traditional agency theory perspective, whereby the notion of self-interest is limited to the maximisation of wealth and monetary benefits. The analysis of data indicated that listed companies in Pakistan avoided providing mandatory disclosure on the construct of board profile, which included information on corporate governance training and the qualification of the members of the board. They did not therefore avail

themselves of opportunities for professional development and good governance practice, both of which could have helped in the improvement of company performance.

This behaviour might have several negative implications. Firstly, it has negative consequences for minority shareholders' interests manifesting agency problem. Furthermore, non-disclosure of such information can result in penalisation by the regulatory bodies and financial penalties. Another important implication of a lack of qualification of these members of the board might be the negative affect on their own political career, which might ultimately lead to a loss of political power. However, despite these negative implications for minority shareholders, as well as for their own political careers, these members of the board do not attain required qualification. Thus their resistance to acquire better qualification (self-interest) overwhelms the monetary and political benefits attached with the attainment of qualification.

Through the evidence stated above, this research strengthens the notion that self-interest might not always be measurable in monetary terms, as it has always been interpreted by existing quantitative corporate governance literature. Thus this research extends the existing agency theory through the conduct of this empirical research.

It was also found that although self-interest and opportunism are central in decisions regarding corporate governance disclosure (Chapter 6). However, rationality played an important role in guiding these decisions (Chapter 5 and Chapter 6). Evidence from research data indicated that, although politically connected firms did not provide high level of voluntary disclosures, they provided high level of mandatory disclosures (Chapter 5).

Template analysis has here validated the perspective of rational choice institutionalism because it was found that politically connected firms provided better mandatory disclosure as regulatory enforcement in the country is quite strict. As no benefits are perceived to be associated with the provision of voluntary corporate governance information, therefore its level remains low. This finding attests that social actors make strategic calculations about the institutional environment and attempt to maximise their benefits rationally. This research thus supports the argument that the rigid assumptions of self-interest, as presented in traditional agency theory, should be studied beyond the inflexibility of certain economic assumptions. This study also highlights the usefulness and importance of studying agency conflict in the real life context. The research also supports the arguments presented in the existing corporate governance research whereby an institutionally sensitive approach might be used for research.

### ***Practical Implications***

As discussed in Chapter 2, Pakistan, like many other developing countries, follows an Anglo-Saxon based model of corporate governance through the introduction of a Code of Corporate Governance in 2002. However, as has been argued by prior research, the Anglo-Saxon model is a market-based model based on a theory of shareholder wealth maximization. It is therefore suitable for a market characterised by widely dispersed owners, efficient and liquid capital and equity markets (where firms are expected to be less dependent on long term bank finance), and well established legal systems where company management is relatively free from close monitoring and control.

However, Siddiqui (2010) argued that the Anglo-Saxon model of corporate governance, as adopted by developing economies is not a suitable model given the economic, legal and corporate context of these countries. Siddiqui (2010) further argued that stock markets in developing countries are less developed and are characterised by high ownership concentration. The Anglo-Saxon model of corporate governance is considered more suitable for application in developed capital markets with dispersed shareholders. However, despite this institutional misalignment, various developing countries, including Pakistan, have adopted this model under the influence of international financial agencies.

The findings of this research indicate that under strict regulatory pressures, companies in Pakistan have started to comply with mandatory corporate governance disclosure requirements. However they do not consider these regulations to be of any use. The delisting of companies after the introduction of corporate governance regulations in Pakistan context demonstrates the reluctance of companies towards compliance. Furthermore, while politically connected firms also adhere to high levels of compliance (Chapter 5 and Chapter 6), the incidence of empty speech demonstrates that compliance is reduced to a box ticking activity. Moreover, the reliability and transparency of disclosure provided by politically connected firms might be questioned. It may be implied that the introduction and implementation of corporate governance and disclosures have not met their original objectives of enhancing transparency and investor protection.

Furthermore, it might be argued that, in order to ensure effective implementation and compliance, international regulatory bodies and local governments in the developing countries need to be more sensitive towards the

country's institutional environment while new corporate governance and disclosure regulations are introduced and implemented. This research provides evidence that politicians extract rents from corporate sector and hide such information through a lack of disclosure. The clear implication is that there is a need to focus on the development of such corporate policies and governance regulations that are compatible with the prevailing institutional environment of the country.

It is recommended that regulators should not ignore the fact that most of the companies in the stock market in Pakistan are family owned and controlled, so governance in such companies might not be improved by implementing an Anglo-Saxon based model of corporate governance. Considering the fact that one set of regulations might not address the governance needs of all companies, the regulators might consider introducing a separate set of corporate governance and disclosure regulations for family owned listed companies. Since these companies are subject to agency conflict between family owners and non-family members/minority shareholders, corporate governance guidelines might assist them in resolving those issues on their own. Moreover, since every family business deals with unique circumstances on account of complexity in family relationships, corporate governance guidelines for family businesses might not be mandatory. These guidelines might be voluntary, with a focus on assisting family firms in devising tailored solutions to their problems.

Since the findings of this research also indicate that the level of disclosure in politically connected firms was lower compared with non-connected firms, this might indicate that politicians' involvement in the corporate sector results in a

conflict of interest between their political and business interests. Thus, the regulatory bodies might consider introducing certain regulations to avoid this conflict of interest. For example, a regulation might be introduced imposing restrictions on the appointment of a politically influential person as chairman of the audit committee.

### **7.3 Quality of Research**

The researcher was aware of the issues concerning the quality of this research. Hence, an assessment of the quality of this research was carried out on the basis of various criteria, as outlined by Bryman and Bell (2011, p. 43). As this research was an in-depth context-based case study and that most of the evidence was gathered through the qualitative analysis of interview data and narrative sections in the annual reports, the assessment criteria for qualitative research - that is, credibility, transferability, dependability and confirmability - are appropriate for evaluation of this study.

Credibility refers to the degree to which the research findings might be taken as believable. Multiple methods of data collection have been used for carrying out an exploratory and context-based inquiry regarding corporate governance disclosure practices. The use of triangulation through multiple sources of evidence has ensured that the data were actually demonstrating the trends which the researcher believed it to be indicating. Agreement in the results obtained from various sources of data and through various methods of data analysis validated the findings of the study. This therefore increased the level of confidence in the inferences drawn from the data (Saunders et al., 2012).

Transferability refers to the extent to which the research findings might be applied to other contexts; that is, how generalisable the research findings prove to be. This research was a qualitative context-based study and this feature tends to limit its generalisability. However, a good level of transferability was ensured through a provision of detailed descriptions of the phenomena studied. The research questions and the reasons for the choice of the research sample have been explained in detail. Various decisions and choices made during the process of research have also been well elaborated. The findings of the study might thus be applicable to similar contexts, particularly to the context of other developing countries.

Dependability refers to the extent to which the findings might generate the same results, if the research were to be repeated. In order to enhance the future replicability of the research, various conceptual terms were clearly explained. The process of categorising annual report data and the template analysis of interview data have indeed been explained in detail in this thesis (Chapter 4). A detailed description regarding the method for analysis of data has been provided. These factors enhance the ease of replication for future researchers. In addition, a detailed account of existing research, employing similar research methodologies, has been provided and an explanation has been provided of how this research is placed in the existing literature in the field (Chapter 3).

Confirmability represents the extent to which the researcher attempts to generate objective results (Bryman and Bell, 2011, p. 43). Multiple methods of data collection have strengthened the objectivity of the data. No inference has been drawn from the data unless the researcher found at least three instances of



evidence in support thereof. An adequate amount of evidence has been provided in support of the conclusions drawn from the data.

### **7.4 Limitations of the Study and Agenda for Future Research**

Although the research provides strong and useful insights on how political connectedness influences corporate governance disclosure, there are some limitations associated with this study.

Firstly, considering political connectedness to be a sensitive topic, some bias in the interview responses is likely to have crept in as some of the respondents might have responded to certain questions cautiously. However, the researcher utilised triangulation in order to overcome this limitation and to enhance the quality of research findings. The results of template analysis were supported by the findings obtained from qualitative content analysis and the analysis of silence and thus raised the level of confidence in results.

Secondly, this is a single country study, aimed at understanding the impact of political connectedness on corporate governance disclosures in Pakistan. It might be considered that qualitative techniques of data analysis are more time consuming, when compared to quantitative analysis. Being that it was an in-depth qualitative study and also included collection and analysis of interview data, the corporate governance disclosure practices of only 40 listed companies have been studied across the different industrial sectors. The research has not utilised any statistical techniques to establish a correlation between the various variables. Thus, research utilising a larger sample of firms utilising the technique of quantitative content analysis might be conducted in the future.

Thirdly, the study has used a measure for direct observation of political connectedness in corporate boards. However, owing to the difficulties in getting access to relevant and reliable data, other mechanisms for establishing political connectedness, such as lobbying and political donations have not been taken into account. This limitation of the research might be addressed in future research whereby new and more effective measures for political connectedness might be developed in the context of Pakistan and other developing countries.

Furthermore, this study was an in-depth investigation of the impact of political connectedness on the level of corporate governance disclosure. The study of transparency and quality of corporate governance disclosure do not then fall within the scope of this research. However, as indicated by the findings of this research, the disclosures provided by politically connected firms might not be reliable and transparent. Therefore, research might be carried out investigating transparency of corporate governance disclosure in politically connected firms.

This research project has successfully fulfilled its objective of providing an understanding of the unique context in which it was conducted. Moreover, as the ownership structure and nature of the capital market in Pakistan is similar to the ownership structure prevailing in many Asian and developing countries, the findings of this research might be useful in seeking explanations in similar institutional contexts. However, this research calls for similar qualitative studies to be carried out in the contexts of developing countries so as to facilitate a comparison and understanding of how institutional forces affect the implementation, development and effectiveness of corporate governance and disclosure regulations in these countries. More context-based research could

also provide an explanation of contradictions in the findings of existing corporate governance research.

**Table of Legislation**

**Statutes**

The Constitution of Pakistan (1973)

Civil Servants Act 1973, Pakistan

Government of India Act 1935

The Companies Ordinance 1984, Pakistan.

UK Data Protection Act 1998, United Kingdom

Freedom of Information Act 2000, United Kingdom

**Statutory Instruments**

KSE 2002 Listing Regulations

Conduct of General Elections Order 2002

**Codes**

The Code of Corporate Governance 2002, Pakistan

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## Appendices

### Appendix A

#### Research Project Information and Consent Form

##### Project Title

The Impact of Political Connectedness on the Quality of Corporate Governance Disclosures in Pakistan

##### Name of the Researcher

Fatima Yusuf – PhD Student- The Open University, UK.

##### Purpose of the Research

This research project is undertaken purely for academic purposes. The objective of the research is to develop an understanding regarding the impact imposed by political connectedness on the quality of corporate governance disclosures in listed companies of Pakistan. The research process will involve **semi-structured interviews** with the participants along with detailed **observational field notes**. In addition to interview data, the research will also include analysis of corporate annual reports. The research responses and data will be used for the purposes of academic analysis only.

##### Duration of the Interview

The interview will be conducted at participant's workplace and will last for duration of approximately one hour.



### **Benefits to the Participants**

As the participants in the research are either experts in the field of corporate governance or senior managers, i.e., representatives of the listed companies, regulatory bodies and audit firms, the outcomes of this research might be of special interest to them. A copy of the research report shall be provided to them after completion of the project.

### **Risks to the Participants**

The research process involves a minimal level of risks. The participants will not encounter any risks that might exceed the level of risks that the participants encounter in everyday life. However, the researcher shall take due care to protect participants from all types of psychological distress and physical risks.

### **Confidentiality and Data Protection**

Every possible precaution will be taken in protecting the confidentiality of the research participants' identities and data. The data collected from the participants will be used for research with their due permission. If any participant does not permit the use of any of the information provided by him/her for research purpose, such data will not be used.

The interviews will be tape recorded and transcribed by the researcher later on. The researcher will take every possible measure to ensure protection of data from unauthorised access, accidental disclosure, loss or destruction. The researcher shall keep the data under password protected storage. The audio data will be stored on the OU secure server which is accessible to the researcher only. The data shall not be kept with the researcher longer than required for the project and will be destroyed once this research project is finished and the research dissertation is completed and formally approved. The data will be accessible to the

researcher, the supervisors and the examining team only and all measures will be taken to ensure that no third party can access the data.

The names of the participants shall be kept confidential. The name of the organisation shall also be kept confidential unless its disclosure is allowed. Pseudonyms shall be used for the purpose of securing anonymity for research participants. The provisions of the Data Protection and Freedom of Information Act, the Open University's Code Of Practice for Research and Those Conducting Research, the Ethics Principles for Research involving Human Participants and, the Economic and Social Research Council's Framework for Research Ethics regarding confidentiality and data protection shall be followed. The results of the data shall be disseminated in the form of a dissertation report and possibly in the form of an article for presentation in an academic conference or by publication in an academic journal.

### **Costs and Compensation**

The research project is funded by The Open University and will be undertaken for the purpose of the PhD thesis. The research participant shall not be obliged to bear any extraordinary costs during the research process. The researcher shall approach the participant at his/her workplace.

### **Voluntary Nature of Participation**

The participant has full right to refuse participation in the research process. In case of agreement of participation, the respondent has the right to withdraw his/her participation before all the research data are analysed and final results are concluded.

### **Contact Details**

In case of any queries about the matters relating to the research project, please free to contact me or my supervisors at The Open University.

**Fatima Yusuf (Researcher)**

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**Professor Jane Frecknall-Hughes (Supervisor)**

T: UK 01908(6) 32565

E: [Jane.Frecknall-Hughes@open.ac.uk](mailto:Jane.Frecknall-Hughes@open.ac.uk)

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**Participation Agreement**

I \_\_\_\_\_ have had the opportunity to read this information and consent form, ask questions about the research project and am prepared to participate in this project. I have been informed about the purpose, duration, risks, and benefits of the project. Moreover, I have been informed that confidentiality of the information shall be protected and the responses shall be used for academic purposes and might be published in the form of articles in academic journals. I assign the copyright for my contribution to the Open University for these purposes. *I have also been informed that I have the right to withdraw from participation before all the research data are analysed and final results are presented to conclusion.*

I understand that if I have any questions or concerns about this project, I can contact the researcher and her supervisors as listed above.

\_\_\_\_\_  
**Participant's Signature**

\_\_\_\_\_  
**Date**

\_\_\_\_\_  
**Researcher's Signature**

\_\_\_\_\_  
**Date**

## **Appendix B**

### **Interview Schedule**

The following interview questionnaire has been developed for the purpose of seeking answers to relevant and important questions. This guideline will help in ensuring that the interview does not lose focus.

#### **From Listed Companies' Managers/ Directors**

##### **1. Process for Preparation**

- i. How are corporate annual reports prepared?
- ii. In addition to the regulatory requirements by SECP, do organisations develop an internal disclosure policy?
- iii. How is it decided whether to disclose information beyond what is required by law?
- iv. Whose interests do disclosure regulations serve?
- v. How does the level of law enforcement affect the quality of disclosures?
- vi. Do you perceive that good disclosures are beneficial for the companies?

##### **2. Quality of Disclosures**

- i. How will you define good quality corporate governance disclosures in the company annual report?
- ii. How do listed companies ensure disclosure of a good quality of information?
- iii. What is your view about the quality of corporate governance disclosures in a listed company's annual reports in Pakistan?
- iv. What would improve the quality of disclosures?

- v. What do you consider are the undesirable consequences/limitations of corporate governance disclosure requirements for listed companies?
- vi. Can compliance with the disclosure regulations provide listed companies with a competitive advantage?
- vii. Is it beneficial for the company to disclose information over and above the minimum disclosure requirements set by corporate governance and reporting regulation?

### **3. Political Connectedness**

- i. Who are the most important people in listed companies, influencing the decisions regarding corporate governance disclosure in annual reports?
- ii. What benefits does political connectedness bring to the company?
- iii. Does political connectedness bring any benefits to the shareholders of the company? If yes, kindly elaborate the nature of the benefits.
- iv. Can you elaborate the process through which political connectedness bring benefits to the company?
- v. How does political connectedness influence organisational policies and practices regarding corporate governance disclosures?
- vi. How does political connectedness play a role in hiring of those human resources in the organisation who are involved in preparation of annual reports?
- vii. How do the members of the board affect hiring process in the organisation?

### **4. Control**

- i. Who controls the management of a listed company?
- ii. How are the interests of the owners of the business protected?



- iii. Are current corporate disclosure practices catering for minority shareholders' interest?

#### **5. Reasons for Poor Quality of Disclosures**

- iv. What do you think can be the possible reasons for poor quality of disclosures in the annual reports of listed companies in Pakistan?

##### **From Managers in Audit Firms**

- i. What, in your opinion, can be the possible reasons for poor quality of disclosures in the annual reports of listed companies of Pakistan?
- ii. Who are the most important and powerful people in listed companies, influencing the quality of corporate governance disclosures in listed companies?
- iii. How, in your opinion, do politically connected members of the board influence company activities?
- iv. How, in your opinion, can the political connectedness of the members of board of directors affect companies' quality of corporate governance disclosures?
- v. How do politically connected people on company boards influence minority shareholder rights?
- vi. How, in your opinion does the quality of disclosures differ in non-connected companies if compared with connected ones?

##### **From Representatives of Regulatory Bodies**

- i. What were the objectives for the introduction of corporate governance disclosure regulations for listed companies of Pakistan?

## Appendices

- ii. How would you define good quality disclosures in the annual report of a listed company?
- iii. Are you satisfied with the quality of corporate governance disclosures by the listed companies in Pakistan?
- iv. Can the imposition of more stringent regulation improve the quality of disclosures in annual reports of listed companies?
- v. How, do you think, can companies improve corporate governance related disclosures in their annual reports?
- vi. Can you quote any incidents (without name) when the regulatory body prosecuted or took action against directors, chief executive or other officers for non-disclosure of material corporate governance information?

## Appendix C



From Dr Duncan Banks  
Chair, The Open University Human Research Ethics Committee  
Email [duncan.banks@open.ac.uk](mailto:duncan.banks@open.ac.uk)  
Extension 59198

To Fatima Yusuf, Faculty of Business & Law

Subject *"The Impact of Political Connectedness on the Quality of Corporate Governance Disclosures in Pakistan."*  
Ref HREC/2013/1462/Yusuf/1

Red form  
Submitted 06 June 2013  
Date 24 June 2013

## Memorandum

This memorandum is to confirm that the research protocol for the above-named research project, as submitted for ethics review, has been given a favourable opinion by the Open University Human Research Ethics Committee.

Please make sure that any question(s) relating to your application and approval are sent to [Research-REC-Review@open.ac.uk](mailto:Research-REC-Review@open.ac.uk) quoting the HREC reference number above. We will endeavour to respond as quickly as possible so that your research is not delayed in any way.

At the conclusion of your project, by the date that you stated in your application, the Committee would like to receive a summary report on the progress of this project, any ethical issues that have arisen and how they have been dealt with.

Regards,

Dr Duncan Banks  
Chair OU HREC

**Appendix D**

<b>Profitability and Dividends – A Comparisons Between Politically Connected and Non Connected Firms Sugar and Textile</b>						
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>Total No of Times Profit Earned or Dividend Announced</b>
<b>Politically Connected firms</b>						
No of Profitable Firms	6	4	6	7	5	28
No of Firms Disclosing Dividends	3	4	4	4	3	18
<b>Non Connected firms</b>						
No of Profitable Firms	9	7	9	8	5	38
No of Firms Disclosing Dividends	7	6	6	7	5	31
<b>Profitability and Dividends – A Comparisons Between Politically Connected and Non Connected Firms Several Sectors</b>						
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>Total No of Times Profit Earned or Dividend Announced</b>
<b>Politically Connected firms</b>						
No of Profitable Firms	6	4	5	6	3	26
No of Firms Disclosing Dividends	4	4	4	5	3	20
<b>Non Connected firms</b>						
No of Profitable Firms	8	8	10	8	7	41
No of Firms Disclosing Dividends	6	6	6	7	6	31